Supreme Court, U.S.
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No. _____

In The

Supreme Court of the United States

COMMONWEALTH OF PUERTO RICO, *et al.*,

Petitioners,

v.

ARECIBO COMMUNITY HEALTH CARE, INC., *et al.*,

Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The First Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

Under established constitutional principles – as set forth in cases ranging from *United States v. Shaw*, 309 U.S. 495, 60 S.Ct. 659, 84 L.Ed. 888 (1940), to *Oklahoma Tax Commission v. Citizen Band Potawatomi Indian Tribe of Oklahoma*, 498 U.S. 505, 111 S.Ct. 905, 112 L.Ed.2d 1112 (1991) – a governmental entity that invokes federal jurisdiction waives its immunity only with respect to mandatory counterclaims that seek relief that does not differ in kind, and does not exceed, the amount of the government's claim. The question presented is:

May Congress establish a bankruptcy-specific exception to that constitutional standard, without violating the Eleventh Amendment, so as to allow a debtor to seek recovery of $8.2 million from the Commonwealth of Puerto Rico in response to a claim of $1.6 million filed by the Commonwealth?

LIST OF PARTIES

The petitioners seeking review of the judgment of the Court of Appeals for the First Circuit are the Commonwealth of Puerto Rico, the Department of Health, and the Administration of Health Services.

The respondents are Carlos Rodríguez Quesada, Chapter 7 Trustee for the bankruptcy estate of Arecibo Community Health Care, Inc. and the United States.

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PETITION FOR A WRIT OF CERTIORARI

Petitioners, the Commonwealth of Puerto Rico, the Department of Health, and the Administration of Health Facilities, respectfully pray that a writ of certiorari issue to review the opinion and judgment entered by the United States Court of Appeals for the First Circuit on rehearing, on October 29, 2001.

OPINIONS BELOW

The opinion on rehearing by the panel of the Court of Appeals is reported at 270 F.3d 17 (*Arecibo Community Health v. Commonwealth of PR*) and is printed in the Appendix ("App.") at pp. 1-22. The panel opinion vacated by the opinion on rehearing is reported at 244 F.3d 241 (*Arecibo Comm. Health Care v. Com. of Puerto Rico*) and is printed in the App. at pp. 23-31. The order denying rehearing *en banc* is unreported and is reprinted in the App. at pp. 77-78.

The order of the District Court denying the Commonwealth of Puerto Rico's request for reconsideration of the March 31, 1999 opinion and order is printed in the App. at pp. 32-33. The opinion and order of the District Court of March 31, 1999 is reported at 233 B.R. 625 (*In re Arecibo Community Health Care, Inc.*) and is printed in the App. at pp. 36-50. The judgment of the same date is printed in the App. at pp. 34-35. The two pertinent decisions of the Bankruptcy Court are unreported and are printed in the App. at pp. 51-62 and pp. 65-76. The judgment of the

bankruptcy court dated October 21, 1997 is printed in the App. at pp. 63-64.

JURISDICTION

The Court of Appeals for the First Circuit issued its opinion on rehearing on October 29, 2001. The order denying rehearing *en banc* was entered on January 14, 2002. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

U.S. Const., Amend. XI, provides:

> The Judicial power of the United States shall not be construed to extend to any suit in law or in equity, commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens or Subjects of any Foreign State.

11 U.S.C. § 106(b), provides:

> (b) A governmental unit that has filed a proof of claim in the case is deemed to have waived sovereign immunity with respect to a claim against such governmental unit that is property of the estate and that arose out of the same transaction or occurrence out of which the claim of such governmental unit arose.

STATEMENT OF THE CASE

A. Facts

From 1984 to 1991, the Puerto Rico Department of Health and the Administration of Health Facilities, both agencies of the Commonwealth of Puerto Rico (collectively referred to as "Puerto Rico"), contracted with Arecibo Community Health Care, Inc. ("ACHI") to operate the Arecibo Regional Hospital. On June 30, 1991, following the termination of the contract, Puerto Rico filed suit against ACHI in the Superior Court of Puerto Rico, alleging that ACHI had failed to render services pursuant to the contract. On July 2, 1991, ACHI filed a Chapter 11 bankruptcy petition.

Puerto Rico filed an unsecured claim for breach of contract damages for $1,650,449.16. After the case was converted to Chapter 7 in February 1994, the trustee filed an adversary action against Puerto Rico in December 1995, asserting claims arising from the same contract and operative facts. The trustee sought to recover $8,204,494.48, plus interest from 1991, attorneys' fees, and litigation costs.

In its Answer to the Complaint, Puerto Rico asserted that the trustee's claims for affirmative relief were barred by the Eleventh Amendment and moved to dismiss his action on that ground.[1] ACHI argued to the bankruptcy court that its request for affirmative relief was proper based on Section 106(a) of the Bankruptcy Code, which

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[1] The First Circuit agreed that Puerto Rico was protected by the Eleventh Amendment to the same extent as the fifty states and that issue has not been contested by ACHI.

purports to abrogate the states' sovereign immunity, and Section 106(b) of the Bankruptcy Code, which deems a state that files a bankruptcy claim to have waived its sovereign immunity with respect to counterclaims arising out of the same transaction or occurrence.

B. Proceedings Below

The bankruptcy court held that this Court's holding in *Seminole Tribe of Florida v. Florida*, 517 U.S. 44, 116 S.Ct. 1114, 134 L.Ed.2d 2219 (1996), required it to find that Sections 106(a) and (b) were both invalid as applied to Puerto Rico. The bankruptcy court reasoned that if Congress could not abrogate the states' Eleventh Amendment immunity under Section 106(a), it equally could not do so under Section 106(b) by what amounted to a conditional waiver. It thus ruled that appellants could not be found to have waived their Eleventh Amendment immunity by filing of a proof of claim. App. at p. 71.

The district court agreed that Section 106(a) was invalid (determination that ACHI did not challenge), but concluded that the "waiver" of immunity prescribed by Section 106(b) was permissible because it was "premise[d] . . . upon an affirmative action by the state to take advantage of, and participate in, the bankruptcy process." App. at p. 48. Puerto Rico requested the district court to reconsider its ruling. While this request was pending, the Supreme Court decided *College Savings Bank v. Florida Prepaid Postsecondary Education Expense Board*, 527 U.S. 666, 119 S.Ct. 2219, 144 L.Ed.2d 605 (1999). Puerto Rico submitted the new holding to the court by means of a supplemental memorandum. However, the

district court declined without comment to reconsider its ruling that Section 106(b) was valid.

Puerto Rico then filed an interlocutory appeal to the First Circuit. On initial hearing, the panel concluded that the language in Section 106(b) was an attempt to create a "constructive waiver" of a state's sovereign immunity. The panel further concluded that, as stated in *College Savings*, Congress could not condition a state's waiver of its Eleventh Amendment protection on its decision to engage in the lawful act of filing a claim with the bankruptcy court. App. at p. 30. Accordingly, it granted Puerto Rico's motion to dismiss the complaint, while noting that ACHI could still defend against the state's claim. App. at p. 31, n.4.

ACHI and the United States moved for rehearing and rehearing *en banc*, noting among other factors that the panel had not addressed the effect of the First Circuit's prior decision in *WJM, Inc. v. Massachusetts Dep't of Public Welfare*, 840 F.2d 996 (1st Cir. 1988) (holding that former Section 106(a) was a permissible means of requiring a state's waiver of sovereign immunity with respect to compulsory counterclaims arising from a proof of claim filed with the bankruptcy court).[2] The panel agreed to rehear the case.

On rehearing, the panel analyzed whether Puerto Rico had waived its immunity by its litigation conduct.

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[2] Prior to amendments to the Bankruptcy Code in 1994, the waiver language that now appears in Section 106(b) was contained in identical form in material respects in Section 106(a) of the Code.

After citing *Gardner v. New Jersey*, 329 U.S. 565, 67 S.Ct. 467, 91 L.Ed. 504 (1947), for the proposition that a debtor could object to a state's claim without violating the Eleventh Amendment, the court then quoted *College Savings'* description of *Gardner* as "stand[ing] for the unremarkable proposition that a State *waives its sovereign immunity* by voluntarily invoking the jurisdiction of the federal court." App. at p. 13 (quoting *College Savings*, 527 U.S. at 681 n.3) (emphasis added). The panel of the Court of Appeals viewed that description as "a broad proposition [of waiver] going beyond the precise holding of *Gardner*," that "[w]e would not lightly confine . . . to the example cited." *Id.*

On that basis, the First Circuit panel concluded that *College Savings* would not require a different result from *WJM*. The court held that the filing of a claim in federal bankruptcy court is qualitatively different from engaging in the commercial activity dealt with in *College Savings* and inherently results in a broad waiver of immunity. App. at pp. 14-15. Accordingly, the court viewed Section 106(b) as based, not on a theory of constructive or forced waiver, but rather on a separate, constitutionally-based notion of consent arising from the invocation of federal jurisdiction. The court reasoned that since neither *Gardner* nor *College Savings* explicitly limited the litigation waiver doctrine, it could be applied to more than just defensive objections or recoupment. Accordingly, the court concluded that the waiver (as codified in Section 106(b)) encompassed all claims that would fall within Rule 13 of the Federal Rules of Civil Procedure. App. at p. 16. The court held that filing a claim waives "the state's immunity with respect to that claim *in toto* and, therefore

. . . encompass[es] compulsory counterclaims, *even though they could require affirmative recovery from the state.*" (Emphasis added.) App. at pp. 18-19.

REASONS FOR GRANTING THE PETITION

Well-established case law from this Court provides that when a government possessing sovereign immunity seeks relief in federal court it also inherently grants the court the power to hear and resolve mandatory, defensive counterclaims, but does not consent to the imposition of relief that is greater than, or different in kind from, that sought by the government in its suit. *See, e.g., United States v. Shaw, supra; United States v. U.S. Fidelity & Guaranty Co.*, 309 U.S. 506, 60 S.Ct. 653, 84 L.Ed. 894 (1940); *Oklahoma Tax Comm'n v. Citizen Band Potawatomi Indian Tribe of Oklahoma, supra.* At issue in this case is whether that principle applies with equal force when states file claims in federal bankruptcy proceedings.

The First Circuit held it does not, deepening an existing conflict among the circuits. Because states routinely file bankruptcy claims, this issue arises with great frequency. In those circuits which agree with the First Circuit, the practical consequences are significant: debtors are encouraged to file bankruptcy when sued by a state, because that allows them to force the state to choose between foregoing any attempt to collect on its claim or opening itself up to unlimited potential liability. Nothing in this Court's jurisprudence justifies that result. To the contrary, this Court has applied the general principle set forth above to bankruptcy and other proceedings where,

like bankruptcy, the government claims a share of a *res*. This Court should grant certiorari to clarify the law in this area and confirm that there is not a bankruptcy exception to Eleventh Amendment waiver rules.

I. The First Circuit's Decision Deepens An Existing Conflict Among the Circuits As to Whether this Court's Limitations on Allowable Counterclaims Against Governmental Entities Applies When States File Claims in Bankruptcy Cases

Outside the bankruptcy context, the lower courts have faithfully and consistently adhered to this Court's decisions setting forth the limited scope of a government's consent to counterclaims. These decisions recognize that a mandatory counterclaim (i.e., one that arises out of the same transaction and occurrence as the government's claim and that invokes the same operative facts and law) that seeks an amount equal to or less than the government's claim, by its very nature, is a *defense* to the government's claim. These claims fall within the definition of "recoupment," which is well recognized as being a *defense*, not a separate claim.[3] On the other hand, where a defendant's counterclaims extend beyond defeating the government's claim and seek affirmative recovery, the

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[3] These recoupment claims, or defenses, are allowed as a logical corollary of the *Gardner* rule that the defendant may defend against the state's claim. As a defense, there is an inherent limit on the relief that may be granted – the ceiling is that set by the amount of the state's original claim; once the state's claim is defeated, there is nothing left to defend. See discussion in *United States v. Iron Mountain Mines, Inc.*, 952 F. Supp. 673, 675-676 (E.D. Cal. 1996).

courts recognize that they are, by definition, no longer being used defensively, cannot be said to be within the scope of the government's consent, and must be based on an independent basis of jurisdiction.

However, when the very same issue has arisen in bankruptcy proceedings in which states have asserted claims, the lower courts have exhibited sharp conflict and confusion. Not only are the circuit courts divided on the correct rule, those courts on the same side of the conflict have disagreed on the rationale for finding the "waiver" that they impose upon states.

A. Prior Decisions of This Court and the Lower Courts Establish the Limited Scope of Waiver Generally

As long ago as 1940, this Court set strict limits on the extent to which a government exposes itself to liability when it voluntarily avails itself of the jurisdiction of a federal court. In *United States v. Shaw, supra,* this Court held that filing a claim against an estate in probate court did not subject the United States to an affirmative cross claim. The Court rejected the private party's argument that "when a sovereign voluntarily seeks the aid of the courts for collection of its indebtedness, it takes the form of a private suitor and thereby subjects itself to the full jurisdiction of the court." 309 U.S. at 501. Moreover, the court cannot provide affirmative relief merely by asserting that its order is "not a judgment but only a 'judicial ascertainment' of credits." *Id.* at 504. Rather, "no judgment may be entered against the government even

though the court has ascertained . . . that the government is actually indebted to the defendants. The judgment should be limited to a dismissal of the . . . claim." *Id.*

In *United States v. U.S. Fidelity & Guaranty Co., supra,* the United States filed a claim in a case arising under the Bankruptcy Act. The debtor filed a counterclaim and the bankruptcy court entered judgments for both parties, with a net balance owing to the debtor. The United States did not appeal that judgment, but subsequently contested the debtor's later attempt to enforce its judgment in response to a collection action by the United States on *its* judgment. The United States conceded that the debtor could assert its judgment to the extent needed to defeat the government's claim, citing *Bull v. United States,* 295 U.S. 247, 261, 55 S.Ct. 695, 79 L.Ed. 1421 (1935), as allowing such recoupment, but the Court agreed that "the Missouri judgment is void insofar as it undertakes to fix a credit against the [United States]." 309 U.S. at 512. This is so, the Court held, even though it would bar adjudication of all issues in one forum, and even though the United States had not appealed the entry of the prior order and was attacking it in a collateral forum. *Id.* at 513-14.

Finally, in *Oklahoma Tax Commission v. Citizen Band Potawatomi Indian Tribe of Oklahoma, supra,* this Court held that even mandatory counterclaims under Federal Rule of Civil Procedure 13 could not be litigated automatically in response to the sovereign's claim. The Indian Nation had sought a declaratory judgment that it was not required to collect state sales taxes. In response, the state sought a declaration that the tribe *was* obligated to do so, as well

as a monetary judgment for the uncollected taxes. Finding that the case was controlled by *U.S. Fidelity & Guaranty Co.*, the Court unanimously rejected the argument that the filing of a claim by a sovereign automatically included a waiver of immunity for all Rule 13 counterclaims, including those seeking relief of a kind different from that sought by the plaintiff. 498 U.S. at 509. As a result, it barred the state's request for monetary relief against the tribe.

In nonbankruptcy cases, the lower courts have had no difficulty in understanding and applying these decisions. They have unanimously agreed that the filing of a claim does not expose the sovereign to relief greater than, or different in kind, from that sought by the sovereign.[4]

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[4] *See, e.g.*, Waylyn Corp. v. United States, 231 F.2d 544, 547 (1st Cir. 1956) ("filing of a suit . . . does not . . . amount to a waiver of sovereign immunity, subjecting the United States to an affirmative adverse judgment on a counterclaim"); *United States v. Forma*, 42 F.3d 759, 765 (2nd Cir. 1994) ("it has long been absolutely clear that the [recoupment] exception does not permit any affirmative recovery . . . on a counterclaim that lacks an independent jurisdictional basis"); *Kingdom of Roumania v. Guaranty Trust Co. of New York*, 250 F. 341 (2nd Cir. 1918) (same rule as to foreign sovereign); *Livera v. First Nat'l State Bank of New Jersey*, 879 F.2d 1186, 1195 (3rd Cir.), *cert. denied*, 493 U.S. 937 (1989); *FDIC v. Lattimore Land Corp.*, 656 F.2d 139, 143 (5th Cir. 1981); *Starr v. Schram*, 143 F.2d 561 (6th Cir. 1944); *Federal Savings & Loan Insurance Corp. v. Quinn*, 419 F.2d 1014, 1017 (7th Cir. 1969); *United States v. Johnson*, 853 F.2d 619, 621 (8th Cir. 1988); *Miller v. Tony & Susan Alamo Found.*, 134 F.3d 910, 916 (8th Cir. 1998); *Jicarilla Apache Tribe v. Andrus*, 687 F.2d 1324, 1344 (10th Cir. 1982); *United States v. Timmons*, 672 F.2d 1373 (11th Cir. 1982); *In re Dep't of Energy Stripper Well Exemption Litigation (Anadarko Production Co. v. New Mexico)*, 956 F.2d 282 (Temp. Emer. Ct. App. 1992).

The same rule has also repeatedly been stated by district courts in cases specifically involving states, as opposed to the federal government.[5]

B. The Courts of Appeal Are Divided, However, As to Whether the Principle Applies to States in Bankruptcy Cases

The courts of appeal disagree on the application of these principles to bankruptcy cases in which states file claims. Much of the confusion stems from their divergent attempts to construe this Court's decision in *Gardner v. New Jersey*. In *Gardner*, the debtor and the state had been involved in prolonged litigation before and during the debtor's bankruptcy over the amount of its taxes. When the state filed a proof of claim in the case, the debtor responded by filing numerous objections and then a petition asking the bankruptcy court to adjudicate those claims. The state argued that the Eleventh Amendment

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[5] *See, e.g., California Indep. Sys. Operator Corp. v. Reliant Energy Servs., Inc.*, 181 F. Supp. 2d 1111, 1124-25 (E.D. Cal. 2001); *United States and New Jersey Dep't of Envtl. Protection v. Rohm and Haas Co.*, 939 F. Supp. 1157, 1161-63 (D.N.J. 1996); *State of New Jersey, Dept. of Envir. Prot. v. Gloucester Environmental Management Services, Inc.*, 923 F. Supp. 651, 664 (D.N.J. 1995); *Kelley ex rel., State of Michigan v. Kysor Indus. Corp.*, 1992 WL 179519 at p. 2 (W.D. Mich. 1992); *CPC Internat'l, Inc. v. Aerojet-General Corp.*, 764 F. Supp. 479, 481-82 (W.D. Mich. 1991), and cases cited therein; *Regents of the Univ. of California v. Eli Lilly & Co.*, 777 F. Supp. 779, 785-86 (N.D. Cal. 1991); *Woelffer v. Happy States of America, Inc.*, 626 F. Supp. 499, 502 (N.D. Ill. 1985); *Georgia Dep't of Human Resources v. Bell*, 528 F. Supp. 17, 26 (N.D. Ga. 1981).

barred the bankruptcy court from entertaining the petition, but the Court held that the determination of the issues in that proceeding and the objections were inherently part of the determination of the state's claim. 329 U.S. at 572-74. The Court articulated its reasoning as follows:

> the procedure of proof and allowance is not transmutted into a suit against the State because the court entertains objections to the claim. The State is seeking something from the debtor. *No judgment is sought against the State.* The whole process of proof, allowance, and distribution is, shortly speaking, an adjudication of interests claimed in a *res*. . . . When the State . . . files a claim against the fund it waives any immunity . . . respecting the adjudication of the claim.

329 U.S. at 573-74 (emphasis added). The case did not involve any counterclaims by the debtor, but merely objections to the state's claim.

The Seventh Circuit, addressing the question under the Bankruptcy Act (which did not have any statutory equivalent of Section 106), squarely rejected the argument that *Gardner* established a broad rule of waiver which permits affirmative relief against a state. In *In re Friendship*, 710 F.2d 1297 (7th Cir. 1983), the court construed *Gardner* as holding "that the limited waiver of sovereign immunity created by the filing of the claim extends only so far as necessary to adjudicate *that* claim, such as considering the objections of other parties to the claim." *Id.* at 1301 (emphasis added). The court approvingly quoted one of its earlier decisions, involving "the closely related area of federal sovereign immunity," which held that

"[w]aiver does not extend to what federal procedure terms 'permissive' counterclaims, . . . claims for affirmative relief in excess of or different in kind from that sought by the plaintiff." *Id.* (quoting *Federal Savings & Loan Ins. Corp. v. Quinn*, 419 F.2d 1014, 1017 (7th Cir. 1969)).

One year earlier the Sixth Circuit also held that by filing a claim in bankruptcy, a state does not consent to the bankruptcy court awarding affirmative relief against it. *See Ohio v. Madeline Marie Nursing Homes No. 1 and No. 2*, 694 F.2d 449 (6th Cir. 1982). In that case, the bankruptcy court held that the Eleventh Amendment barred the debtor's "efforts to pursue a counterclaim against the State of Ohio in excess of the state's claim in the Chapter 11 proceedings." *Id.* at 457. The Sixth Circuit agreed. The court principally relied on an earlier Ninth Circuit opinion which, in a case involving a bankruptcy claim filed by the United States, held that "affirmative recovery against the sovereign is not a corollary of the sovereign's right to sue or present a claim for bankruptcy adjudication." *Id.* at 462 (quoting *Danning v. United States*, 259 F.2d 305 (9th Cir. 1958), *cert. denied*, 359 U.S. 911 (1959)).

Three other circuits have reached the contrary result, though for varying reasons. The First Circuit in this case ruled that affirmative relief is available to a debtor in bankruptcy based on its view that *College Savings* (through its generalized citation to *Gardner*) approved a broad consent-by-litigation theory, although conceding that *Gardner* itself had not announced that theory. The Tenth Circuit, writing before *College Savings*, concluded that *Gardner* itself had announced a broad common-law waiver rule that allows unlimited relief on mandatory

counterclaims. *In re Straight*, 143 F.3d 1387 (10th Cir.), *cert. denied*, 525 U.S. 982 (1998). The court stated that Section 106(b) merely codified (or perhaps even narrowed) that common-law waiver rule. 143 F.3d at 1390.[6]

Relying on an entirely different ground, the Second Circuit also held that debtors can seek affirmative relief against states by asserting counterclaims. In *In re 995 Fifth Avenue Assoc., L.P.*, 963 F.2d 503 (2nd Cir. 1992), the court held that Congress could condition a state's participation in a bankruptcy proceeding on its waiver of Eleventh Amendment immunity. According to the court, Congress accomplished that goal when it enacted former Section 106(a), now Section 106(b). *Id.* at 508-09. Although that decision may not survive *College Savings*, it adds to the conflict and confusion on the issue.[7]

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[6] The Tenth Circuit failed to mention that just two years earlier, in *United States v. Murdock Machine and Engineering Company of Utah*, 81 F.3d 922 (10th Cir. 1996), it had reached just the opposite conclusion with respect to the scope of "waiver" that could be inferred from the filing of a claim by the United States under the Bankruptcy Act. As discussed in Section III, *infra*, there is no justification for distinguishing the sovereign immunity of the United States from that of the states in this context.

[7] The First Circuit also noted the decisions of the Eighth and Eleventh Circuits. Those decisions, *In re Rose*, 187 F.3d 926, 930 (8th Cir. 1999) and *In re Burke*, 146 F.3d 1313, 1319 (11th Cir. 1998), while not dealing with the exact issue here, are based on the same broad view of *Gardner* espoused by the Tenth Circuit. *Rose*, for instance, held there was a "well-established common law rule that submission of a proof of claim by a state is sufficient to 'waive any immunity which it otherwise might have had respecting the adjudication of the claim,' " and cited *Gardner* and *College Savings* as allowing the debtor to file a

This division of lower-court authority warrants this Court's attention.[8] The Ninth Circuit's position is likewise undefined. In *In re Lazar*, 237 F.3d 967 (9th Cir.), *cert. denied*, 122 S.Ct. 458 (2001), the court treated the issue as an open question as regards states, but refrained from taking any position because it concluded the state's claim outweighed the debtor's in any event. *Id.* at 979. The court mentioned but failed to distinguish its earlier opinion in *Danning, supra*, in which it had rejected the argument that the filing of a claim by the United States allowed a debtor to seek affirmative relief. As discussed below, there is no basis in this Court's precedent for such a distinction between federal and state immunity. As things now stand, whether a state's claim in bankruptcy

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discharge complaint against a state that filed a proof of claim. In *Burke*, the court held that *Gardner's* rule of waiver with respect to "adjudication" of a claim was broad enough to allow the debtor to sue the state (not just state officials) for alleged violations of the discharge injunction and the automatic stay. The court did not rule on whether Section 106(b) was constitutional, preferring to rest its opinion solely on its reading of *Gardner*, and suggesting that *Straight* may well have correctly stated that Section 106(b) merely codified the *Gardner* rule.

[8] The First Circuit also cited *In re Creative Goldsmiths, Inc.*, 119 F.3d 1140 (4th Cir. 1997), as supporting its position, but the court there did not reach this precise issue because it found the asserted counterclaims were not compulsory. Moreover, the Fourth Circuit's observations in dicta on this issue cut both ways. While referring broadly to a waiver of "any Eleventh Amendment immunity" with respect to mandatory counterclaims, the court specifically reasoned that a state "may not invoke sovereign immunity to protect itself against the interposition of *defenses* to its action." *Id.* at 1148 (emphasis added). Limiting mandatory counterclaims to those that are defenses is the position that Puerto Rico argues for here.

results in its exposure to affirmative monetary obligations to the debtor depends entirely on the circuit within which the state is located. The Constitution should not permit such liability to be imposed on the states and commonwealths of Colorado, Connecticut, Kansas, Maine, Massachusetts, New Hampshire, New Mexico, New York, Oklahoma, Puerto Rico, Rhode Island, Utah, Vermont, and Wyoming, but not on the states and commonwealths of Illinois, Indiana, Kentucky, Michigan, Ohio, Tennessee, and Wisconsin. Nor should it leave the remaining states in a quandary as to whether and to what extent they open themselves up to unlimited liability by trying to enforce their laws against parties that choose to file bankruptcy.

In the end, the conflict in the circuits is based on a fundamental disagreement over the meaning of this Court's sovereign immunity decisions. The First, Second, and Tenth Circuits have concluded that those decisions created, or permitted them or Congress to create, a state-bankruptcy-claim exception to the rule announced in the *U.S. Fidelity & Guaranty Co.* line of cases, in order to allow the imposition of affirmative relief against the state. The Sixth and Seventh Circuits declined to find such an exception to the general constitutional rule. Because only this Court can clarify the meaning of and interrelationship between its sovereign immunity decisions, review by this Court is needed.

II. The Issues Raised Are Important and Recurring

The broad scope of waiver asserted by the First Circuit in bankruptcy cases "presents a state with something of a Hobson's choice: 'either subject yourself to federal court jurisdiction or take nothing.' " App. at p. 21 (citing *Texas ex rel., Bd. Of Regents of Univ. of Texas v. Walker,* 142 F.3d 813, 822 (5th Cir. 1998)). That statement accurately sets forth the significance of the problem faced by states under the First Circuit's view. Although no one disputes that a debtor may assert recoupment to defeat a state's recovery from the estate, the First Circuit's decision goes much further. Under the First Circuit's analysis, if the state files a bankruptcy claim in *any* amount, it opens itself to compulsory counterclaims of an *unlimited* amount. In this case, for instance, the state sought $1.6 million and the First Circuit's opinion allows the debtor to seek at least *five times* that amount from the state.

While this would be problematic in any event, it is made worse by the dichotomy that is drawn between bankruptcy and nonbankruptcy cases. Under the principles of limited waiver set by this Court, there is no question that a defendant's attempt to obtain affirmative relief would be denied had the state initially filed its complaint in a nonbankruptcy federal forum. Such relief would be allowed only on a showing of voluntary, unequivocal consent by the state and that consent could be as broad or as limited as the state chose.[9] Yet, merely

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[9] *See, e.g., Class Plaintiffs v. Seattle,* 955 F.2d 1268 (9th Cir. 1992), *cert. denied,* 113 S.Ct. 408 (1992) (state may consent to participate in settlement negotiations regarding a complaint

by filing bankruptcy, the defendant, now turned "debtor," may unilaterally obtain a new right to seek unlimited affirmative recovery from the state. This Court recently reiterated in *Raleigh v. Illinois Department of Revenue*, 530 U.S. 15, 120 S.Ct. 1951, 147 L.Ed.2d 13 (2000), the bedrock principle that rights in bankruptcy are based on nonbankruptcy law, unless explicitly changed by the Code. The filing of a petition, this Court has held, does not change those rights, even with respect to matters as limited as the burden of proof on a claim. Yet in this case, where a fundamental constitutional provision is at issue, the First Circuit's decision imposes a wholesale reversal of the inherent immunity rights of the state based upon the debtor's decision to file bankruptcy.

Granting this unilateral right to defendants to vastly expand the scope of the state's "consent" plainly will provide a substantial incentive to defendants to file bankruptcy when faced with litigation by a state. Absent a bankruptcy filing, they are limited to seeking affirmative relief in the manner and forums set by the state; but after such a filing, they force the state to choose between foregoing any attempt to collect on its claim or opening itself up to unlimited potential liability.[10]

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filed against it without consenting to actual litigation of the complaint).

[10] *Cf. State of New Jersey, Dept. of Envir. Prot. v. Gloucester Environmental Management Services, Inc.*, 923 F. Supp. 651, 663 (D.N.J. 1995) (where litigation of CERCLA claims is limited to federal court, "notion that state [bringing such suit] thereby acts voluntarily to submit its rights to federal court is fairly debatable").

This is no minor problem for states. There were almost 1.5 million bankruptcies filed last year and Chapter 11 bankruptcies, where the largest claims occur, increased by 16 percent. States have claims in tens or even hundreds of thousands of those 1.5 million cases for debts owed for taxes, student loans, domestic support obligations, contracts and loans entered into between the state and the debtor, and many other matters. If filing those claims, in whatever amount, opens the state up to *unlimited* potential liability on mandatory counterclaims, that threat alone may often force it to forego any effort to pursue those claims, no matter how valid. This is a "Hobson's choice" that this Court has never required a sovereign to face before – even in a bankruptcy context – and states should not be required to face it now.

Certiorari should be granted in order to clarify the law with respect to this important and frequently recurring issue, and to reaffirm that states do not expose themselves to affirmative liability by seeking to recover moneys validly owed to them.

III. The Decision Below Was Incorrect

In allowing ACHI to seek recovery of at least $8.2 million from Puerto Rico in response to the Commonwealth's claim of $1.6 million,[11] the First Circuit erred. As discussed above, this Court has three times announced a

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[11] Indeed, the amount could be much higher – the trustee did not file a claim until four and a half years after the bankruptcy case was filed, and sought interest for that entire time period, plus attorneys fees and costs.

rule that limits the scope of allowable counterclaims against a sovereign, and the lower courts have correctly followed that lead and applied that rule to suits against the United States, the states, Indian tribes, and foreign sovereigns. If those cases are not applicable here, it can only be because they either do not apply in bankruptcy generally, or do not apply to states when they file bankruptcy claims. Neither position is justified under the existing case law.

The argument that bankruptcy is somehow different from any other type of federal case is easily disposed of. As noted above, the *U.S. Fidelity & Guaranty* case was itself a bankruptcy case. As there was no statutory equivalent to Section 106 in effect, the Court was, perforce, deciding and announcing the applicable constitutional standard. The companion *Shaw* case applied the same principle when the United States sought relief in a state probate case, which, like bankruptcy, is an *in rem* action that divides a limited estate among competing creditors. In both cases, this Court made clear that a decision imposing affirmative liability on a sovereign in response to a claim filed *by* that sovereign was invalid. Indeed, in *U.S. Fidelity & Guaranty* the Court held that the decision providing affirmative relief to a private party against the government was *void* and could be collaterally attacked, even when it had not been timely appealed. Clearly, there is no bankruptcy exception, as such.

Alternatively, the argument might be that the principle of limited waiver is generally only applicable to the federal government and not to states. As confirmed by the cases cited above (fns. 4 and 5), that is plainly incorrect in any context outside of bankruptcy. Although the

exact contours of the immunities of different sovereigns vary, cases involving core principles such as the clear statement rule and the showing necessary to prove waiver, have not distinguished between the various types of sovereigns. This Court has explicitly made this point in cases such as *California v. Deep Sea Research, Inc.*, 523 U.S. 491, 506-07, 118 S.Ct. 1464, 140 L.Ed.2d 626 (1998) ("Court has recognized a correlation between sovereign immunity principles applicable to States and the Federal Government"), and *Kiowa Tribe of Oklahoma v. Mfg. Technologies, Inc.*, 523 U.S. 751, 756, 118 S.Ct. 1700, 140 L.Ed.2d 981 (1998) (tribal immunity akin to that of other governments until abrogated).[12]

Thus, one can only reach the First Circuit's position by positing that, notwithstanding the equivalence of federal and state immunity and notwithstanding the application of this principle in bankruptcy cases involving the federal government, there is a unique bankruptcy-state-claim-specific exception to this rule. The First Circuit reached that conclusion based on its view that *Gardner* did not rule out such a position and that a casual reference to *Gardner* in *College Savings* was meant to actually express a drastic widening of the limited ruling in *Gardner*. App. at p. 13.

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[12] Differences that have been recognized arise out of the fundamental constitutional structure. For instance, the effect of the Supremacy Clause is to let the United States sue a state, but not vice versa, and the Fourteenth Amendment (but not Article I) allows Congress to abrogate state immunity in a limited range of cases, while there is no similar provision for states *vis-a-vis* the United States. None of those structural differences are present here.

The First Circuit's decision piled ambiguous dicta upon itself to reach a policy-based judgment that it viewed as the "appropriate" way to analyze this issue. In taking that decision, however, the court erred by ignoring this Court's longstanding admonition that any statutes or doctrines which purport to limit the immunity inherently held by governmental entities must be strictly construed.[13] The court of appeals stood that principle on its head when it looked to see not whether this Court's precedent clearly *requires* the waiver of immunity argued for by ACHI, but rather whether that precedent unequivocally *rejects* any such argument.

The court of appeals' starting premise – that any uncertainties as to the scope of prior opinions by this Court should be construed *against* immunity – if applied generally, would mean that states would have no immunity unless and until this Court explicitly and unequivocally proclaimed that they enjoyed it. That is an approach this Court has never espoused and it certainly makes little sense here. To assume that this Court would announce a major expansion of the scope of implied consent merely by describing a prior case as announcing an "unremarkable conclusion" would fly in the face of established principles of constitutional adjudication. To further assume that this Court did so without even mentioning or distinguishing its prior cases, or explaining

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[13] *See United States v. Nordic Village, Inc.*, 503 U.S. 30, 34, 112 S.Ct. 1011, 117 L.Ed.2d 181 (1992) (requiring that the scope of a sovereign immunity waiver be strictly construed in favor of the sovereign); *McMahon v. United States*, 342 U.S. 25, 26, 72 S.Ct. 17, 96 L.Ed. 26 (1951) (requiring that statutes which waive immunity be construed in favor of the sovereign).

that this new principle of "consent" would be applicable only to states and only in bankruptcy cases, would be even more surprising. The far more reasonable conclusion is that the First Circuit erred in discovering this new interpretation of *Gardner*; the broad "consent by litigation" theory that it has espoused does not exist.

Assuming, then, that the courts cannot rely on that type of consent, the decision can stand only if the First Circuit correctly held that Section 106(b) is constitutional, notwithstanding this Court's decision in *College Savings*. If, as shown *supra*, the First Circuit erred in determining the scope of the common law, then it cannot rely on its assertion that Section 106(b) does no more than codify the existing law. The First Circuit asserted that filing litigation was qualitatively different from the activities dealt with in *College Savings*. However, the court did not articulate why this was so (apart from its incorrect reliance on its consent-by-litigation theory), or on what basis Congress gains this authority. It obviously is not based on the Fourteenth Amendment, nor can it be derived from the Spending Clause, since litigating in federal court does not result in the United States conferring a monetary benefit on the state from the federal coffers in exchange for the waiver.

If Congress has an unlimited power to require broad "waivers" of state immunity as a consequence of filing federal litigation – so long as it does so clearly – that is a matter of great significance. It would be a wholly new basis for Congressional abrogation and one which Puerto Rico firmly believes finds no basis in the Constitution. As

such, it is plainly an issue that warrants consideration now.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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App. 1

United States Court of Appeals,
First Circuit.

ARECIBO COMMUNITY HEALTH CARE, INC.,
Plaintiff, Appellee,

v.

COMMONWEALTH OF PUERTO RICO, Department of Health and the Administration of Health Services,
Defendants, Appellants,

Carlos E. Rodriguez-Quesada, Trustee, Appellee.

United State[s] of America,
Intervenor, Appellee.

No. 00-1774.

Heard March 6, 2001.
Decided Oct. 29, 2001.

Leticia Casalduc-Rabell, Assistant Solicitor General, with whom Roberto J. Sanchez-Ramos, Solicitor General, and Vanessa Lugo-Flores, Deputy Solicitor General, were on brief, for appellants.

Craig Goldblatt, with whom Anne Harkavy, Wilmer, Cutler & Pickering, Johnny Rivera-Gonzales, Igor J. Dominguez, and Carlos E. Rodriguez-Quesada, were on brief, for appellee.

Mark B. Stern, Attorney, Civil Division, Department of Justice, with whom Stuart E. Schiffer, Acting Assistant Attorney General, Guillermo Gil, United States Attorney, and H. Thomas Byron III, Attorney, Civil Division, Department of Justice, were on brief, for the United States of America, amicus curiae.

Before TORRUELLA, Circuit Judge, COFFIN, Senior Circuit Judge, and CAMPBELL, Senior Circuit Judge.

OPINION ON REHEARING

TORRUELLA, Circuit Judge.

This appeal requires us to determine the validity of § 106(b) of the Bankruptcy Code, 11 U.S.C. § 106(b),[1] in light of the Supreme Court's most recent Eleventh Amendment jurisprudence.[2] Upon initial review, we concluded that § 106(b) was constitutionally infirm. After rehearing and helpful supplemental briefing, however, we reach a different determination and conclude that our earlier decision misinterpreted recent Supreme Court precedent and, in doing so, failed to accord proper controlling value to an extant decision of this circuit.

We therefore vacate our earlier decision and affirm the district court's holding that upon appellants' filing a proof of claim in the bankruptcy court, they are not shielded by the Eleventh Amendment from compulsory

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[1] Section 106(b) of the Bankruptcy Code provides that the filing of a proof of claim in federal bankruptcy court by "[a] governmental unit . . . is deemed [to be a] waiver of sovereign immunity with respect to a claim against such governmental unit that is property of the estate and that arose out of the same transaction or occurrence out of which the claim of such governmental unit arose." 11 U.S.C.A. § 106(b) (West Supp.2001).

[2] The Eleventh Amendment provides: "The Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens or Subjects of any Foreign State." U.S. Const. amend. XI. It has long been established that, notwithstanding its literal language, the Eleventh Amendment extends to bar suits instituted in federal courts against a state by its own citizens. *See Hans v. Louisiana*, 134 U.S. 1, 10 S.Ct. 504, 33 L.Ed. 842 (1890).

counterclaims arising from the same transaction or occurrence as was the subject of the proof of claim.

I. Background

In March 1984, the Puerto Rico Department of Health (the "Department") and the Administration of Health Facilities ("AFASS") – both of which are instrumentalities of the Commonwealth of Puerto Rico – executed a series of contracts with a private entity, Arecibo Community Health Care, Inc. ("ACHI"), for the administration of the Arecibo Regional Hospital, a government-owned hospital in Arecibo, Puerto Rico. The last of these contracts was terminated in 1991.

On June 30, 1991, the Department filed suit against ACHI in the Superior Court of Puerto Rico. The complaint alleged that ACHI had failed to render services pursuant to the administration contract with the Department. Thereafter, on July 2, 1991, ACHI filed a voluntary petition for bankruptcy under Chapter 11 of the Bankruptcy Code. The bankruptcy court determined that the contract in dispute had been terminated prior to the filing of the petition, whereupon the Department and AFASS proceeded to file a proof of an unsecured claim for ACHI's breach of the administration contract. The claim was for the amount of $1,650,449.16.

The bankruptcy proceeding was subsequently converted to one under Chapter 7, and a trustee was appointed. The trustee commenced an adversary action against the Department and AFASS asserting various claims under state law. The claims allegedly arise from the same contract and operative facts as both the action filed by the

Department in the Puerto Rico courts and the proof of claim filed in federal bankruptcy court. The trustee sought to recover the sum of $8,204,494.48, interest accrued since 1991, attorneys' fees, and litigation costs.

In their Answer to the Complaint, the Department and AFASS ("appellants") asserted that the trustee's claims were barred by the Eleventh Amendment.[3] Thereafter they moved to dismiss the action on this ground. The bankruptcy court concluded that the holding in *Seminole Tribe of Florida v. Florida*, 517 U.S. 44, 54, 116 S.Ct. 1114, 134 L.Ed.2d 252 (1996) (holding that Congress may not abrogate the state's Eleventh Amendment immunity pursuant to its Article I powers), required such an outcome and concluded that both sections 106(a)[4] and (b) were invalid as applied to appellants. The bankruptcy court reasoned that if Congress could not abrogate the states' Eleventh Amendment sovereign immunity under *Seminole Tribe*, it could not do so by what amounts to a conditional waiver. It thus ruled that appellants could not be deemed to have waived their Eleventh Amendment immunity by their filing of a proof of claim in this case.

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[3] It is well settled in this circuit that the Commonwealth of Puerto Rico "is protected by the Eleventh Amendment to the same extent as any state. . . . " *Ortiz-Feliciano v. Toledo-Davila*, 175 F.3d 37, 39 (1st Cir.1999).

[4] Section 106(a) states in part: "Notwithstanding an assertion of sovereign immunity, sovereign immunity is abrogated as to a governmental unit . . . " 11 U.S.C.A. § 106(a) (West Supp.2001).

The district court agreed with the bankruptcy court as to the invalidity of § 106(a),[5] but concluded that the waiver of immunity under § 106(b) was permissible because it was "premise[d] . . . upon an affirmative action by the state to take advantage of, and participate in, the bankruptcy process." *In re Arecibo Cmty. Health Care, Inc.*, 233 B.R. 625, 630 (D.P.R.1999). Appellants requested that the district court reconsider its ruling. While this request was pending, the Supreme Court decided *College Savings Bank v. Florida Prepaid Postsecondary Education Expense Board*, 527 U.S. 666, 119 S.Ct. 2219, 144 L.Ed.2d 605 (1999) (*College Savings*). The district court, without comment, declined to reconsider its ruling that § 106(b) was valid.

Appellants then brought their cause to this court by way of an interlocutory appeal.[6] In our initial decision we held that § 106(b) violates the Eleventh Amendment. *See Arecibo Cmty. Health Care, Inc. v. Commonwealth of P.R.*, 244 F.3d 241, 245 (1st Cir.2001). We construed § 106(b) to create a "constructive waiver" of a state's sovereign

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[5] The parties to this appeal do not challenge the lower court's conclusion that Congress lacks the authority to abrogate Puerto Rico's Eleventh Amendment immunity pursuant to § 106(a). *See In re Sacred Heart Hosp.*, 133 F.3d 237, 243 (3d Cir.1998) (holding that § 106(a) is not a valid abrogation provision). *But see In re Hood*, 262 B.R. 412, 414 (6th Cir.BAP2001) (holding that § 106(a) does not offend the Eleventh Amendment because Congress may validly abrogate a state's Eleventh Amendment immunity by legislating pursuant to the power to establish uniform bankruptcy laws, U.S. Const. art. I, § 8, cl. 4).

[6] "[P]retrial orders granting or denying Eleventh Amendment immunity [are] immediately appealable." *Metcalf & Eddy v. Puerto Rico Aqueduct & Sewer Auth.*, 991 F.2d 935, 937 (1st Cir.1993).

immunity. *Id.* Noting that the Supreme Court has recently found constructive waiver insufficient to defeat sovereign immunity, *see College Savings*, 527 U.S. at 680, 119 S.Ct. 2219, we concluded that Congress could not condition a state's waiver of its Eleventh Amendment protection on its decision to engage in the lawful act of filing a claim with the bankruptcy court. *See Arecibo Cmty. Health Care*, 244 F.3d at 245.

After we rendered our decision, ACHI ("appellee") and the United States moved for rehearing and rehearing en banc. The panel agreed to rehear the case.

II. Analysis

A. Standard of review

Whether the district court correctly upheld the constitutionality of § 106(b) and found that appellants had waived their Eleventh Amendment immunity is an issue of law. We therefore review the lower court's ruling *de novo*. *See Metcalf & Eddy, Inc. v. Puerto Rico Aqueduct & Sewer Auth.*, 991 F.2d 935, 938 (1st Cir.1993).

B. Stare decisis

In *WJM, Inc. v. Massachusetts Department of Public Welfare*, 840 F.2d 996 (1st Cir.1988), we held that a former Bankruptcy Code provision identical in all relevant respects to current § 106(b) was a permissible means of obtaining a state's waiver of sovereign immunity with respect to compulsory counterclaims arising from a proof

of claim filed with the bankruptcy court.[7] *Id.* at 1005. The United States and appellee both argue that we are bound by this decision as a matter of stare decisis.

The principle that a ruling of law by a panel of this court is binding upon subsequent panels is "an integral component of our jurisprudence." *Stewart v. Dutra Constr. Co.*, 230 F.3d 461, 467 (1st Cir.2000). Adherence to "our precedent-based system of justice places a premium on finality, stability, and certainty in the law. . . . " *Id.* (citing *Hubbard v. United States*, 514 U.S. 695, 711, 115 S.Ct. 1754, 131 L.Ed.2d 779 (1995)). A departure from stare decisis must therefore be supported by some "special justification." *Dickerson v. United States*, 530 U.S. 428, 443, 120 S.Ct. 2326, 147 L.Ed.2d 405 (2000) (quoting *United States v. I.B.M. Corp.*, 517 U.S. 843, 856, 116 S.Ct. 1793, 135 L.Ed.2d 124 (1996)).

We have identified two circumstances in which a departure from stare decisis may be warranted. The first arises when "[a]n existing panel decision may be undermined by controlling authority, subsequently announced, such as an opinion of the Supreme Court, an en banc opinion, or a statutory overruling." *Williams v. Ashland Eng'g Co.*, 45 F.3d 588, 592 (1st Cir.1995). In the second circumstance, "[w]hen emergent Supreme Court case law

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[7] That provision, former section 106(a) of the Bankruptcy Code, stated: "A governmental unit is deemed to have waived sovereign immunity with respect to any claim against such governmental unit that is property of the estate and that arose out of the same transaction or occurrence out of which such governmental unit's claim arose." 11 U.S.C.A. § 106(a) (1982) (superseded).

calls into question a prior opinion of another court, that court should pause to consider its likely significance before giving effect to an earlier decision." *Carpenters Local Union No. 26 v. U.S. Fidelity & Guar. Co.*, 215 F.3d 136, 141 (1st Cir.2000).

In this case, appellants do not argue that the earlier decision in *WJM* has been directly overruled by subsequent controlling authority; rather, they contend that the Supreme Court's decision in *College Savings* provides intervening authority that, at the very least, requires this Court to revisit the soundness of *WJM* in light of recent jurisprudential developments.

In *College Savings*, the court addressed a private suit against an arm of the State of Florida for allegedly engaging in false and misleading advertising of its tuition prepayment plan in violation of § 43(a) of the Lanham Act, 15 U.S.C.A. § 1125(a) (1995). The Trademark Remedy Clarification Act ("TRCA") amended the Lanham Act to provide that state entities "shall not be immune, under the eleventh amendment . . . from suit in Federal court . . . for any violation under this Act," and that remedies shall be available against state entities "to the same extent as such remedies are available . . . in a suit against" non-state entities. Pub.L. 102-280, § 3(b), 106 Stat. 3567 (1992) (codified in 15 U.S.C.A. § 1122 (1995)).

Relying on the theory of "constructive waiver" announced in *Parden v. Terminal Railway of the Alabama State Docks Department*, 377 U.S. 184, 84 S.Ct. 1207, 12 L.Ed.2d 233 (1964), the petitioners in *College Savings* argued that the TRCA placed the state on adequate notice that its unlawful conduct in interstate commerce would

legitimately waive its Eleventh Amendment immunity from private suits for monetary damages under the Lanham Act. The court, however, rejected the petitioners' constructive waiver theory and overruled *Parden*. *See College Savings*, 527 U.S. at 680, 119 S.Ct. 2219. The court reasoned that a constructive-waiver approach is fundamentally incompatible with its "cases requiring that a State's express waiver of sovereign immunity be unequivocal." *Id.* (citing *Great N. Life Ins. Co. v. Read*, 322 U.S. 47, 64 S.Ct. 873, 88 L.Ed. 1121 (1944)). The court also recognized that allowing constructive waivers would, "as a practical matter, permit Congress to circumvent the anti-abrogation holding of *Seminole Tribe*." *Id.* at 683, 119 S.Ct. 2219.

Appellants in the present case contend that § 106(b) and the holding in *WJM* violate the central teaching of *College Savings* – namely, that Congress may not smuggle an abrogation provision past the courts merely by dressing it up to notify a state that it will waive its Eleventh Amendment immunity by engaging in a certain activity. *Cf. College Savings*, 527 U.S. at 683, 119 S.Ct. 2219 (noting that "[f]orced waiver and abrogation are not even different sides of the same coin – they are the same side of the same coin"). *WJM* did not, however, rely explicitly on *Parden* in affirming the validity of the Bankruptcy Code's waiver provision.[8] Nonetheless, certain language in the opinion – particularly the numerous references to the "notice" provided by the statute – may reveal a soupcon

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[8] Indeed, then-Chief Judge Campbell noted in *WJM* that *Parden* was likely ripe for a partial overruling by the Supreme Court. *See* 840 F.2d at 1002 n. 6.

of reliance on a constructive-waiver approach. *Compare WJM*, 840 F.2d at 1003 ("The statute puts the state on notice that if it chooses to enter the federal government's exclusive bankruptcy preserve by filing a claim, it must pay a price: a partial waiver of its sovereign immunity.") (footnote omitted) *with College Savings*, 527 U.S. at 681, 119 S.Ct. 2219 ("In [the constructive-waiver situation], the most that can be said with certainty is that the State has been put on notice that Congress intends to subject it to suits brought by individuals. That is very far from concluding that the State made an altogether voluntary decision to waive its immunity.") (citations and quotations omitted). We must therefore undertake a more searching analysis than the ordinary operation of stare decisis would permit, inquiring whether the theory of waiver embodied by § 106(b) remains sound in the wake of *College Savings*.

C. Waiver of Eleventh Amendment immunity

It has long been recognized that a state's sovereign immunity is "a personal privilege which it may waive at pleasure."[9] *Clark v. Barnard*, 108 U.S. 436, 447, 2 S.Ct. 878, 27 L.Ed. 780 (1883). "The decision to waive that immunity, however, 'is altogether voluntary on the part of the

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[9] A state's Eleventh Amendment immunity may also be abrogated by congressional enactment, provided however that Congress expresses its unequivocal intention to do so and acts pursuant to a valid grant of constitutional authority. *See Laro v. New Hampshire*, 259 F.3d 1, 5 (1st Cir.2001) (quoting *Board of Trs. of the Univ. of Ala. v. Garrett*, 531 U.S. 356, 121 S.Ct. 955, 962, 148 L.Ed.2d 866 (2001)).

sovereignty.' " *College Savings*, 527 U.S. at 675, 119 S.Ct. 2219 (quoting *Beers v. Arkansas*, 61 U.S. (20 How.) 527, 529, 15 L.Ed. 991 (1858)). Thus, the "test for determining whether a State has waived its immunity from federal-court jurisdiction is a stringent one." *Atascadero State Hosp. v. Scanlon*, 473 U.S. 234, 241, 105 S.Ct. 3142, 87 L.Ed.2d 171 (1985).

A state may waive its Eleventh Amendment immunity by making a " 'clear declaration' that it intends to submit itself to the jurisdiction of the federal courts." *College Savings*, 527 U.S. at 676, 119 S.Ct. 2219 (quoting *Read*, 322 U.S. at 54, 64 S.Ct. 873). Such a declaration may be expressed, for example, in a state statute or constitutional provision. However, in keeping with the Supreme Court's admonition that a state's consent to suit in federal court must be "stated by the most express language or by such overwhelming implications from the text as [will] leave no room for any other reasonable construction," *Edelman v. Jordan*, 415 U.S. 651, 673, 94 S.Ct. 1347, 39 L.Ed.2d 662 (1974) (quotations omitted), we have held that " 'in order for a state statute or constitutional provision to constitute a waiver of Eleventh Amendment immunity, it must specify the state's intention to subject itself to suit in federal court.' " *Acevedo López v. Police Dep't of P.R.*, 247 F.3d 26, 28 (1st Cir.2001) (quoting *Atascadero State Hosp.*, 473 U.S. at 241, 105 S.Ct. 3142).

Similarly, a state may also explicitly waive the protections of the Eleventh Amendment by choosing to participate in a federal program for which waiver of immunity is a stated condition. *See Mills v. Maine*, 118 F.3d 37, 50 (1st Cir.1997) (citing *Atascadero State Hosp.*, 473 U.S. at 241, 105 S.Ct. 3142); *Alden v. Maine*, 527 U.S. 706, 755, 119

S.Ct. 2240, 144 L.Ed.2d 636 (1999) ("Nor, subject to constitutional limitations, does the Federal Government lack the authority or means to seek the States' voluntary consent to private suits.") (citing *South Dakota v. Dole*, 483 U.S. 203, 107 S.Ct. 2793, 97 L.Ed.2d 171 (1987)). Mere participation by a state in a federal program does not, however, establish the state's consent to be sued in federal court; the state's decision to waive its immunity as a condition of participating in the federal program also requires " 'express language or . . . such overwhelming implications from the text as [will] leave no room for any other reasonable construction. . . . ' " *Fla. Dep't of Health & Rehabilitative Servs. v. Fla. Nursing Home Ass'n*, 450 U.S. 147, 150, 101 S.Ct. 1032, 67 L.Ed.2d 132 (1981) (per curiam) (quoting *Edelman*, 415 U.S. at 673, 94 S.Ct. 1347).

Lastly, a state may waive its immunity through its affirmative conduct in litigation.[10] *See Paul N. Howard Co. v. Puerto Rico Aqueduct & Sewer Auth.*, 744 F.2d 880, 886 (1st Cir.1984). Most pertinent to the issue faced here is the maxim that a federal court "will find a waiver . . . if the State voluntarily invokes [its] jurisdiction. . . . " *College Savings*, 527 U.S. at 675-76, 119 S.Ct. 2219 (citing *Gunter v.*

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[10] A state official may only waive the state's sovereign immunity during the course of litigation where specifically authorized to do so by that state's constitution, statutes, or decisions. *See Ford Motor Co. v. Dep't of Treasury*, 323 U.S. 459, 469, 65 S.Ct. 347, 89 L.Ed. 389 (1945) (holding that state official lacked authorization to voluntarily waive the state's Eleventh Amendment immunity). On appeal, the Commonwealth has not pressed the argument that its officials lacked the authority under the laws of Puerto Rico to waive the protections of the Eleventh Amendment in a bankruptcy proceeding.

Atlantic Coast Line R. Co., 200 U.S. 273, 284, 26 S.Ct. 252, 50 L.Ed. 477 (1906)). *See also Clark*, 108 U.S. at 447-48, 2 S.Ct. 878 (holding that state waived its Eleventh Amendment immunity by intervening in a federal case as a claimant of a fund).

In *Gardner v. New Jersey*, 329 U.S. 565, 67 S.Ct. 467, 91 L.Ed. 504 (1947), the Supreme Court held that a state's sovereign immunity did not bar a debtor from asserting defensive objections to a proof of claim filed by the state in a bankruptcy proceeding. The court reasoned:

> he who invokes the aid of the bankruptcy court by offering a proof of claim and demanding its allowance must abide the consequences of that procedure. . . . When the State becomes the actor and files a claim against the fund, it waives any immunity which it otherwise might have had respecting the adjudication of the claim.

Id. at 573-74, 67 S.Ct. 467. In *College Savings*, the Supreme Court affirmed the vitality of the *Gardner* rule, stating: "[*Gardner*], which held that a bankruptcy court can entertain a trustee's objections to a claim filed by a State, stands for the unremarkable proposition that a State waives its sovereign immunity by voluntarily invoking the jurisdiction of the federal courts." 527 U.S. at 681 n. 3, 119 S.Ct. 2219. This is a broad proposition, going beyond the precise holding of *Gardner*.[11] We would not lightly confine its meaning to the example cited.

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[11] Indeed, the court in *College Savings* could have limited the import of *Gardner* by characterizing it as a decision that does not implicate the Eleventh Amendment at all. That is, it could have stated that the defensive objection to the state's proof of claim at issue in *Gardner* was simply not a "suit . . . commenced

Despite its express approval of *Gardner*'s waiver principle, appellants read *College Savings* to require us to hold that *WJM* has become constitutionally untenable and that § 106(b) must be invalidated. Appellants note the court's remark that: "[W]e think where the constitutionally guaranteed protection of the States' sovereign immunity is involved, the point of coercion is automatically passed – and the voluntariness of waiver destroyed – when what is attached to the refusal to waive is the exclusion of the State from otherwise lawful activity." *College Savings*, 527 U.S. at 687, 119 S.Ct. 2219. Using this statement as their springboard, appellants urge upon us the premise that the filing of a proof of claim with the federal bankruptcy court is "otherwise lawful activity" that is no different from the activity the court in *College Savings* held to be insufficient for waiver, namely, "the voluntary and nonessential activity of selling and advertising a for-profit educational investment vehicle in interstate commerce. . . ." *Id.* at 680, 119 S.Ct. 2219. If this premise holds true, appellants argue, § 106(b) must be ruled unconstitutional.

We do not accept appellants' contention that no relevant difference exists between engaging in commercial activity and filing a proof of claim in a federal bankruptcy court. Although it is certainly "lawful" for a state to file a proof of claim, we believe that calling upon a federal court's jurisdiction is fundamentally different, for

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or prosecuted against . . . [a] State" within the meaning of the Eleventh Amendment. *Cf. Gardner*, 329 U.S. at 573-74, 67 S.Ct. 467 ("If the claimant is a State, the procedure of proof and allowance is not transmuted into a suit against the State because the court entertains objections to the claim.").

purposes of the Eleventh Amendment, from merely conducting commercial activity. The Supreme Court itself recognized in *College Savings* that a state relinquishes its immunity under the Eleventh Amendment "if [it] voluntarily invokes [the] jurisdiction [of the federal courts]. . . . " *Id.* at 675-76, 119 S.Ct. 2219. Indeed, the court found this proposition to be so well established as to be "unremarkable." *Id.* at 681 n. 3, 119 S.Ct. 2219 (citing *Gardner v. New Jersey*, 329 U.S. 565, 67 S.Ct. 467, 91 L.Ed. 504 (1947)). *Cf. New York v. Irving Trust Co.*, 288 U.S. 329, 333, 53 S.Ct. 389, 77 L.Ed. 815 (1933) ("If a state desires to participate in the assets of a bankrupt, she must submit to appropriate requirements by the controlling power. . . . ").

The conclusion that a state's filing of a proof of claim may validly effect a partial waiver of its sovereign immunity is further buttressed by those cases which hold that other constitutional rights are considered to be waived by the same mechanism.[12] For example, an individual who files a proof of claim with the bankruptcy court waives his Seventh Amendment right to a jury trial for a related preference action brought by the debtor. *See Langenkamp v. Culp*, 498 U.S. 42, 44, 111 S.Ct. 330, 112 L.Ed.2d 343 (1990); *see also Katchen v. Landy*, 382 U.S. 323, 336-37, 86 S.Ct. 467, 15 L.Ed.2d 391 (1966) (holding that although creditor might be entitled to a jury trial on the preference

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[12] By contrast, in *College Savings* the court noted that the constructive-waiver mechanism rejected in that case is "simply unheard of in the context of other constitutionally protected privileges." 527 U.S. at 681, 119 S.Ct. 2219.

issue if he presented no claim in the bankruptcy proceeding and awaited plenary suit by the trustee, he is not so entitled when the issue arises as part of the processing of his claims in the bankruptcy proceedings). Similarly, the filing of a proof of claim waives an individual's due process right to insist on minimum contacts within the forum state before being subject to the court's jurisdiction.[13] *See In re PNP Holdings Corp.*, 99 F.3d 910, 911 (9th Cir.1996) (per curiam).

In sum, we do not read § 106(b) to rely on the now discredited theory of constructive waiver. Instead, that provision draws on the well-established principle of equity that a state waives its Eleventh Amendment immunity by availing itself of the jurisdiction of the federal courts.

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[13] This is not to say that an entity filing a claim with the bankruptcy court must forfeit the entire panoply of constitutional rights. Yet, even if this were a case of waiver by a state's participation in a federal program (as in the second category of waiver noted above), it would not be impermissible under the Eleventh Amendment. *Cf. Dole*, 483 U.S. at 211, 107 S.Ct. 2793 (noting that "in some circumstances the . . . inducement offered by Congress might be so coercive as to pass the point at which pressure turns into compulsion") (citation and quotations omitted). The state, which might otherwise recover nothing from an insolvent debtor, receives a substantial benefit in exchange for its partial waiver of sovereign immunity. Thus, we think the quid pro quo for the State's waiver of immunity is not so coercive as to raise constitutional concerns.

D. Scope of waiver

Appellants also argue that, even if the waiver principle of *Gardner* remains sound, the scope of waiver permitted in *Gardner* represents the very outer limits of constitutionality. *See Gardner*, 329 U.S. at 573-74, 67 S.Ct. 467 ("If the claimant is a State, the procedure of proof and allowance is not transmuted into a suit against the State because the court entertains objections to the claim. . . . No judgment is sought against the State."). In other words, appellants theorize that any waiver that would permit an affirmative recovery from the state's coffers would exceed the boundaries of the Eleventh Amendment.

Yet, to the extent we are asked to determine whether § 106(b) permissibly waives a state's immunity only with regard to defensive counterclaims for recoupment, or whether that provision may be applied, as written, to allow for a broader affirmative recovery from the state, we believe both that the precedential effect of *WJM* is decisive on this issue and that, in any event, allowance of a broader affirmative recovery is the legally and constitutionally appropriate way to construe the scope of this waiver.

Nothing in *College Savings* purports to restrict the constitutionally permissible scope of waiver triggered by the state's invocation of the jurisdiction of a federal court. *Cf.* 527 U.S. at 676, 119 S.Ct. 2219 ("Nor is this a case in which the State has affirmatively invoked our jurisdiction."). If anything, *College Savings* affirms and reinforces the notion that a broad waiver of immunity may be premised on a state's unequivocal conduct demonstrating

its willingness to submit to the jurisdiction of a federal court. *See id.* at 675-76, 681 n. 3, 119 S.Ct. 2219 (waiving immunity by affirmatively invoking the jurisdiction of the federal courts); *id.* at 687-88, 119 S.Ct. 2219 (voluntarily waiving immunity as a condition of participating in federal programs). Although the scope of waiver found constitutional in *Gardner* and affirmed in *College Savings* was limited to recoupment – and thus narrower in scope than § 106(b) – nothing in either decision explicitly precludes a broader rule of waiver. *See In re Lazar*, 237 F.3d 967, 979 (9th Cir.2001), *petition for cert. filed*, 70 U.S.L.W. 3090 (U.S. July, 19, 2001) (No. 01-128); *see also* Richard H. Fallon et al., *Hart and Wechsler's The Federal Courts and the Federal System* 123-24 (4th ed. Supp.2000) (suggesting that when a state voluntarily invokes federal jurisdiction, the permissible extent of the state's Eleventh Amendment waiver may go beyond the bounds of *Gardner*); Teresa K. Goebel, Comment, *Obtaining Jurisdiction over States in Bankruptcy Proceedings after Seminole Tribe*, 65 U. Chi. L.Rev. 911, 925 (1998) ("The *Gardner* Court held that the defensive counterclaim rule was constitutional, but did not foreclose the possibility that a broader test may be constitutional.") (footnotes omitted).

The language of § 106(b) itself provides for a waiver of all claims arising out of the same transaction or occurrence as the state's claim. This language creates a waiver, the scope of which is essentially similar to compulsory counterclaims under the Federal Rules. *See* Fed.R.Civ.P. 13(a); *cf.* Fed.R.Civ.P. 13(c) (stating that a counterclaim "may claim relief exceeding in amount or different in kind from that sought in the pleading of the opposing party"). Where a state avails itself of the federal courts to

protect a claim, we think it reasonable to consider that action to waive the state's immunity with respect to that claim *in toto* and, therefore, to construe that waiver to encompass compulsory counterclaims, even though they could require affirmative recovery from the state. The alternative approach would have the unfortunate effect of preventing the complete adjudication of the claim in a single forum, undermining the principles that led the framers of the Federal Rules to compel the litigation of certain counterclaims as a part of a single lawsuit.

Recent cases from our sister circuits lend further support to *WJM* and our conclusion here that § 106(b) validly waives a state's Eleventh Amendment immunity with respect to the full amount of any compulsory counterclaims. In *In re Straight,* 143 F.3d 1387 (10th Cir.1998), the Tenth Circuit held that § 106(b) permissibly waived the state's Eleventh Amendment immunity with respect to compulsory counterclaims arising from the state's proof of claim. As the court stated, § 106(b) "does not pretend to abrogate a state's immunity, it merely codifies an existing equitable circumstance under which a state can choose to preserve its immunity by not participating in a bankruptcy proceeding or to partially waive that immunity by filing a claim." *Id.* at 1392. Similarly, the Fourth Circuit has held that "to the extent a [debtor]'s assertions in a state-instituted federal action, including those made with regard to a state-filed proof of claim in a bankruptcy action, amount to a compulsory counterclaim, a state has waived any Eleventh Amendment immunity against that counterclaim in order to avail itself of the federal forum." *In re Creative Goldsmiths, Inc.,* 119 F.3d

1140, 1148 (4th Cir.1997).[14] And in a decision that is only somewhat more vintage, the Second Circuit held that former § 106(a) of the Bankruptcy Code (the same waiver provision we addressed in *WJM*) validly waived a state's sovereign immunity with respect to compulsory counterclaims arising from the same transaction or occurrence as was the subject of the state's proof of claim. *See In re 995 Fifth Ave. Assoc., L.P.*, 963 F.2d 503, 509 (2d Cir.1992).[15]

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[14] Although the Fourth Circuit upheld the substance of § 106(b), it stated in dictum that: "While 11 U.S.C. § 106(b) may correctly describe those actions that, as a matter of constitutional law, constitute a state's waiver of the Eleventh Amendment, it is nevertheless not within Congress' power to abrogate such immunity by 'deeming' a waiver." *See In re Creative Goldsmiths*, 119 F.3d at 1147. Whether Congress lacks the authority to use certain language in codifying an existing principle of waiver is not a question that would alter the outcome of this case. We therefore need not address it.

[15] Consistent with *Gardner*, several circuits have recognized that a state's decision to invoke the bankruptcy court's jurisdiction will effect some waiver of Eleventh Amendment immunity. With the exception of the Seventh Circuit, however, those courts have yet to decide whether the scope of waiver extends to counterclaims that would permit affirmative recovery against the state. *But cf. In re Friendship Medical Center, Ltd.*, 710 F.2d 1297, 1301 (7th Cir.1983) (holding that scope of waiver extends only to counterclaims in the nature of offset or recoupment). We find nothing in the language of the decisions of the Ninth, Eighth, or Eleventh Circuits that would be incompatible with our decision here or our prior holding in *WJM*. *See, e.g., In re Lazar*, 237 F.3d at 978 ("[W]hen a state or an 'arm of the state' files a proof of claim in a bankruptcy proceeding, the state waives its Eleventh Amendment immunity with regard to the bankruptcy estate's claims that arise from the same transaction or occurrence as the state's claim."); *In re Rose*, 187 F.3d 926, 930 (8th Cir.1999) ("[The Missouri state agency's]

We recognize that our conclusion here presents a state with something of a Hobson's choice: "either subject yourself to federal court jurisdiction or take nothing." *Texas ex rel. Bd. of Regents of Univ. of Tex. v. Walker*, 142 F.3d 813, 822 (5th Cir.1998). If the state chooses to file a proof of claim with the court, it exposes itself to liability arising from a compulsory counterclaim; if it declines to file a proof of claim, it will be permanently barred from collecting its debt or, for that matter, collecting a pro rata share of the bankruptcy estate. Even the Eleventh Amendment, however, does not ensure a state the choice of a desirable alternative. *See WJM*, 840 F.2d at 1004-05 ("[A]n effective waiver [of Eleventh Amendment immunity] . . . may occur even when the waiving party is between a rock and a hard place.") (citations omitted). As with any case of a knowing and intelligent waiver of rights, the state has the option (however unattractive that option may be) of determining whether the potential benefit from waiving its immunity will exceed the potential liability. If the state expects participation in the bankruptcy to yield a net gain, it may file a claim and waive its immunity with respect to certain counterclaims. Conversely, if the state expects its participation to yield a net loss, it may forego the bankruptcy proceedings and retain its immunity from suit. The unfairness the state may face in being forced

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submission of proofs of claims in [the debtor's] bankruptcy case waived its immunity in related proceedings required to adjudicate the dischargeability of those claims."); *In re Burke*, 146 F.3d 1313, 1319 (11th Cir.1998) ("[B]y filing a proof of claim in the debtors' respective bankruptcy proceedings, the State waived its sovereign immunity for the purposes of the adjudication of those claims.").

into making this election is certainly no greater than that faced by any creditor who must decide whether to forego certain constitutional protections by submitting to the bankruptcy proceedings.

Moreover, we believe any potential unfairness resulting from a state having to waive its immunity as a prerequisite for participation in the bankruptcy proceedings is placed in perspective by recognizing the concrete unfairness that a contrary rule would impose on the other bankruptcy creditors, whose pro rata share of the bankruptcy estate would be diminished because the estate cannot obtain the full amount of debt owed to it by the state. "[T]he law of bankruptcy is founded upon principles of equity. That foundation requires all persons or entities in the same class must be treated alike. Thus, creditors coming to the bankruptcy court for relief expect they will fare no better or no worse than others of their stature." *In re Straight,* 143 F.3d at 1389.

III. Conclusion

For the reasons stated above, we **VACATE** our prior panel decision and **AFFIRM** the ruling of the district court. This matter is remanded to the district court for further proceedings consistent with this opinion.

ARECIBO COMMUNITY HEALTH CARE, INC., Plaintiff, Appellee,

v.

COMONWEALTH OF PUERTO RICO, Department of Health and the Administration of Health Services, Defendants, Appellants,

Carlos E. Rodriguez-Quesada, Trustee-Appellee.

No. 00-1774.

United States Court of Appeals, First Circuit.

Heard March 6, 2001.

Decided April 5, 2001.

Richard H. Fallon, Jr., with whom Edgardo Muñoz, John M. García and García & Fernández, were on brief, for appellants.

Carlos E. Rodríguez-Quesada, with whom Igor J. Domínguez Law Offices and Johnny Rivera-González, were on brief, for appellee.

Before TORRUELLA, Chief Judge, COFFIN, Senior Circuit Judge, and LEVIN H. CAMPBELL, Senior Circuit Judge.

TORRUELLA, Chief Judge.

Section 106(b) of the Bankruptcy Code, 11 U.S.C § 106(b), provides that the filing of a proof of claim in federal bankruptcy court by "[a] governmental unit . . . is deemed [to be a] waiv[er of] sovereign immunity with respect to a claim against such governmental unit that is

property of the estate and that arose out of the same transaction or occurrence out of which the claim of such governmental unit arose."

The central issue presented by this appeal is whether this provision violates the Eleventh Amendment[1] when it is applied to a state or a state-like political entity. *See Jusino Mercado v. Commonwealth of Puerto Rico,* 214 F.3d 34, 39 (1st Cir.2000) (a "phalanx of cases" holds that Puerto Rico should be treated like the states for Eleventh Amendment purposes); *Metcalf & Eddy v. Puerto Rico Aqueduct & Sewer Auth.,* 945 F.2d 10, 11 n. 1 (1st Cir.1991), *rev'd on other grounds,* 506 U.S. 139, 113 S.Ct. 684, 121 L.Ed.2d 605 (1993) ("Puerto Rico is to be treated as a state for Eleventh Amendment purposes."). We answer this question in the affirmative and rule that the application of § 106(b) to the Commonwealth of Puerto Rico by virtue of its having filed a proof of claim in the bankruptcy court violates the Eleventh Amendment. We thus reverse the decision of the district court in this respect. *See In re Arecibo Cmty. Health Care, Inc.,* 233 B.R. 625 (D.P.R.1999).

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[1] U.S. Const., amend. XI:

> The Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens or Subjects of any Foreign State.

In *Edelman v. Jordan,* 415 U.S. 651, 662-63, 94 S.Ct. 1347, 39 L.Ed.2d 662 (1974), the Supreme Court ruled that, notwithstanding its literal language to the contrary, the Eleventh Amendment's prohibition extends to suits instituted in federal courts against a State by its own citizens.

Procedural Background

The bankruptcy court in this case dismissed this adversary action against appellant Commonwealth of Puerto Rico on the same basis as is alleged before us, that is, that such an action was barred by the Eleventh Amendment. On appeal, the district court reversed the ruling of the bankruptcy court and remanded the matter for further proceedings. *Id.*

This is an interlocutory appeal from the decision of the district court. Appellate jurisdiction exists by virtue of 28 U.S.C. § 1291. *See Puerto Rico Aqueduct and Sewer Auth. v. Metcalf & Eddy, Inc.*, 506 U.S. 139, 144-45, 113 S.Ct. 684, 121 L.Ed.2d 605 (1993).

The Facts

In March 1984, instrumentalities of the Commonwealth of Puerto Rico, the Puerto Rico Department of Health (the "Department") and the Administration of Health Facilities ("AFASS"), executed a series of contracts with a private entity, Arecibo Community Health Care, Inc. ("ACHI"), for the administration of the Arecibo Regional Hospital, a government-owned hospital in Arecibo, Puerto Rico. The last of these contracts was terminated in 1991.

On June 30, 1991, the Department filed a breach of contract suit against ACHI for matters arising from the aforementioned circumstances in the Superior Court of Puerto Rico, Arecibo Part. Thereafter, on July 2, 1991, ACHI filed a voluntary petition for bankruptcy under Chapter 11 of the Bankruptcy Code. The bankruptcy

court determined that the contract in dispute had been terminated prior to the filing of the petition, whereupon the Department and AFASS proceeded to file a proof of an unsecured claim for services paid to, and not rendered by, ACHI. The claim was for the amount of $1,650,449.16.

Subsequently, the bankruptcy proceeding was converted to one under Chapter 7 and a trustee appointed. The trustee commenced an adversary action against the Department and AFASS asserting various claims allegedly arising out of the same contract and operative facts as were the subject of the action filed by the Department in the Puerto Rico courts and the proof of claim filed in federal bankruptcy court. The trustee sought to recover the sum of $8,204,494.48, interest accrued since 1991, attorneys' fees and litigation costs. It is this adversary action by the trustee that raises the issue presented by this appeal.

In their Answer to the Complaint the appellants specifically preserved their Eleventh Amendment immunity defense. Thereafter they moved to dismiss the action on this ground. The bankruptcy court concluded that the holding in *Seminole Tribe of Fla. v. Florida*, 517 U.S. 44, 54, 116 S.Ct. 1114, 134 L.Ed.2d 252 (1996) (Congress may not abrogate the State's Eleventh Amendment immunity pursuant to its Article I powers), required such an outcome and concluded that both sections 106(a)[2] and (b) were invalid as applied to appellants. The bankruptcy court

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[2] Section 106(a) provides for the blanket abrogation of sovereign immunity under circumstances not relevant to this appeal. The district court's decision regarding this clause was not appealed and is thus not before us.

reasoned that if Congress could not abrogate the States' Eleventh Amendment sovereign immunity under *Seminole Tribe*, it could not do so here with what amounts to a conditional waiver. It thus ruled that appellants could not be deemed to have waived their Eleventh Amendment immunity by reason of their filing a proof of claim in this case.

The district court agreed with the bankruptcy court as to the invalidity of § 106(a), but resolved that this incapacity did not carry over to § 106(b) because the waiver resulting thereunder was "premise[d] . . . upon an affirmative action by the state to take advantage of, and participate in, the bankruptcy process." *Arecibo Cmty. Health Care*, 233 B.R. at 630. Appellants requested that the district court reconsider its ruling. While this request was pending, the Supreme Court decided *College Savings Bank v. Florida Prepaid Postsecondary Education Expense Board*, 527 U.S. 666, 119 S.Ct. 2219, 144 L.Ed.2d 605 (1999) (Congress lacks power under Article I to deem that a state has waived its Eleventh Amendment immunity by engaging in interstate commerce.). The district court, without comment, declined to reconsider its ruling that § 106(b) was valid.

Discussion

In *Seminole Tribe*, the Supreme Court identified the two premises upon which the Eleventh Amendment stands as:

> [F]irst, that each State is a sovereign entity in our federal system; and second, that "[i]t is inherent in the nature of sovereignty not to be

> amenable to the suit of an individual without its consent."

517 U.S. at 54 & n. 7, 116 S.Ct. 1114 (internal quotations omitted). A third premise could very well be added after *College Savings Bank:* although a State can waive its Eleventh Amendment immunity from suit, the "test for determining whether a State has waived its immunity from federal court jurisdiction is a stringent one." *College Sav. Bank,* 527 U.S. at 675, 119 S.Ct. 2219 (internal quotations omitted).

In *College Savings Bank,* the Court was presented with a theory of "constructive waiver" of sovereign immunity based on the State of Florida's conduct in engaging in interstate marketing and other federally-regulated activities. As a result of this conduct a suit was filed against the State in federal court by a private party alleging false advertising practices under the Lanham Act, 15 U.S.C. § 1125(a). Under the Trademark Remedy Clarification Act, an amendment to the Lanham Act, Congress had unequivocally legislated to the effect that state agencies engaging in false representations in commerce "shall not be immune, under the Eleventh Amendment . . . or any other doctrine of sovereign immunity, from suit in Federal court by any person, including any governmental or nongovernmental entity." 15 U.S.C. § 1122(b).

In passing upon the validity of this provision the Court stated:

> There is a fundamental difference between a State's expressing unequivocally that it waives its immunity, and Congress's expressing unequivocally its intention that if the State takes certain action it shall be deemed to have waived

> that immunity. In the latter situation, the most that can be said with certainty is that the State has been put on notice that Congress intends to subject it to suits brought by individuals. That is very far from concluding that *the State* has made an "altogether voluntary" decision to waive its immunity.

College Savings Bank, 527 U.S. at 680-81, 119 S.Ct. 2219 (internal quotes omitted). Applying what we have previously dubbed as the third premise of Eleventh Amendment doctrine, a stringent testing of allegations that a State has waived its sovereign immunity, the Court found the "constructive waiver" theory defective because it contravened the settled principle that these waivers must be voluntarily and unequivocally declared by the State, *see id.* at 680-81, 119 S.Ct. 2219, and further, because "[r]ecognizing a congressional power to exact constructive waivers of sovereign immunity through the exercise of Article I powers [in contrast to its Fourteenth Amendment power] would . . . permit Congress to circumvent the antiabrogation holding of *Seminole Tribe*," *id.* at 683, 119 S.Ct. 2219.

Lastly, the Court rejected the notion that a State might be deemed to have waived its immunity voluntarily in cases where its action was free from coercion, stating:

> Nor do we think that the constitutionally grounded principle of state sovereign immunity is any less robust where, as here, the asserted basis for constructive waiver is conduct that the State realistically could choose to abandon. . . . Permitting abrogation or constructive waiver of

> the constitutional right only when [that condition is satisfied] would of course limit the evil – but it is hard to say that that limitation has any more support in text or tradition than, say, limiting abrogation or constructive waiver to the last Friday of the month.

Id. at 684, 119 S.Ct. 2219.

The validity of Section 106(b), already under serious doubt after *Seminole Tribe, see In re Creative Goldsmiths of Washington, D.C., Inc.*, 119 F.3d 1140, 1147 (4th Cir.1997), is clearly undermined by the holding in *College Savings Bank*. Section 106(b) of the Bankruptcy Code is Congress's attempt, under its Article I powers, to construe a State's commercial activity as a waiver of its sovereign immunity. This is precisely that which is prohibited by *College Savings Bank*. We can see no principled reason to distinguish the legislation in this case, or to sustain its constitutionality, in the face of the Supreme Court's recent decision regarding sovereign immunity.[3]

We thus rule that § 106(b) of the Bankruptcy Code violates the Eleventh Amendment of the Constitution and that the adversary proceeding instituted against the Commonwealth of Puerto Rico in bankruptcy court should be

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[3] Like *College Savings Bank*, this is not "a case in which the State has affirmatively invoked [the federal court's] jurisdiction." 527 U.S. at 675, 119 S.Ct. 2219. As previously indicated, the Department filed its breach of contract claim in the Commonwealth court, but later needed to file a proof of claim in federal court because ACHI filed for bankruptcy protection.

dismissed.[4] The decision of the district court is **reversed** and this matter is **remanded** for action consistent with this opinion.

We have considered all other issues and arguments presented by appellees and find them either without merit or unnecessary to decide in view of our decision.

No costs imposed.

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[4] We note that our ruling does not affect appellee's ability to defend against the Commonwealth's proof of claim. *See Gardner v. New Jersey*, 329 U.S. 565, 574, 67 S.Ct. 467, 91 L.Ed. 504 (1947) ("When the State becomes the actor and files a claim against the fund it waives any immunity which it otherwise might have had respecting the adjudication of the claim."). The Supreme Court reaffirmed *Gardner* in *College Savings Bank*. *See* 527 U.S. at 681 n. 3, 119 S.Ct. 2219.

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF PUERTO RICO

IN RE: ARECIBO COMMUNITY HEALTH CARE, INC. Debtor	**Civil No. 98-1625(SFC)** Bankruptcy Case No. 91-4594(GAC)
CARLOS E. RODRIGUEZ-QUESADA Plaintiff-Trustee-Appellant v. COMMONWEALTH OF PUERTO RICO, et al. Defendants-Appellees	Adversary Case No. 95-0150(GAC)

ORDER

(Filed Mar. 31, 2000)

Before the Court are the Defendants-Appellees' Motion for Rehearing, **(Docket #13)**, and Motion Supplementing Legal Argument Based on New Case Law. **(Docket #14)**.[1] The Court has reviewed these motions along with the rest of the documents in the file and finds that it should reaffirm its Opinion and Order of March 31, 1999, **(Docket #10)**, and its Judgment of even date,

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[1] Also before the court is Plaintiff-Appellant's Opposition to Defendant's Motion Requesting a Rehearing, **(Docket #17)**.

(Docket #11), therefore Defendants motions for rehearing are **DENIED**.

SO ORDERED.

In San Juan, Puerto Rico, this 31st day of March, 2000.

/s/ Salvador E. Casellas
SALVADOR E. CASELLAS
United States District Judge

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF PUERTO RICO

In re: ARECIBO COMMUNITY HEALTH CARE, INC. Debtor	**Civil No. 98-1625(SEC)** **Bankruptcy Appeal**
CARLOS RODRIGUEZ QUESADA Appellant v. COMMONWEALTH OF PUERTO RICO DEPARTMENT OF HEALTH, et al. Appellee	

JUDGMENT

(Filed Mar. 31, 1999)

Pursuant to Opinion and Order of even date, the decision of the Bankruptcy Court is **AFFIRMED IN PART** and **REVERSED IN PART**. This action shall be **REMANDED** to the Bankruptcy Court for further proceedings consistent with the Opinion and Order. Judgment is hereby entered accordingly.

SO ORDERED.

In San Juan, Puerto Rico, this 31st day of March, 1999.

/s/ Salvador E. Casellas
SALVADOR E. CASELLAS
United States District Judge

In re ARECIBO COMMUNITY HEALTH CARE, INC., Debtor,

Carlos Rodriguez Quesada, Appellant,

v.

Commonwealth of Puerto Rico Department of Health, et al., Appellee.

No. Civ. 98-1625(SEC).

United States District Court, D. Puerto Rico.

March 31, 1999.

Igor Dominguez-Pérez, Hato Rey, Puerto Rico, for appellant.

Isabel Abislaimán-Quileź, Garcia & Fernández, Hato Rey, Puerto Rico, for appellee.

OPINION AND ORDER

CASELLAS, District Judge.

Pending before the Court is an appeal **(Dockets # 1, 7)** taken by Carlos Rodriguez Quesada, trustee for debtor Arecibo Community Health Care, Inc. (the "trustee"), of an order from the United States Bankruptcy Court for the District of Puerto Rico ("Bankruptcy Court") entered on April 18, 1998. In its order, issued in Case No. 95-04594(GAC), the Bankruptcy Court dismissed the adversary proceedings in Case No. 95-0150(GAC), commenced by the trustee against the Department of Health of the Commonwealth of Puerto Rico ("DOH") and the "Administracion de Facilidades y Servicios de Salud"

("AFASS") to recover monies allegedly owed by DOH and AFASS to the estate. The Bankruptcy Court dismissed the adversary proceedings pursuant to its determination that Sections 106(a) and 106(b) of the Bankruptcy Code, which provide for abrogation of a state's Eleventh Amendment sovereign immunity under certain circumstances, are unconstitutional and that DOH and AFASS enjoy sovereign immunity which precludes the trustee's suit for damages against said entities.

For the reasons stated below in this Opinion and Order, the Bankruptcy Court's decision is **AFFIRMED IN PART** and **REVERSED IN PART** and this action **REMANDED** for further proceedings consistent with this Opinion and Order.

Factual Background

The instant appeal presents an issue of law for the Court, namely, whether Sections 106(a) and 106(b) of the Bankruptcy Code are unconstitutional abrogations of a state's sovereign immunity. However, we shall recount the basic facts as they were summarized by the bankruptcy court, insofar as they will illustrate the Court's analysis of the statutory provisions at issue.

Debtor initiated voluntary bankruptcy proceedings under Chapter 11 of the Bankruptcy Code on July 2, 1991, when defendants DOH and AFASS terminated the contract with debtor for the operation of the Arecibo Regional Hospital. Subsequent to the termination of the contract, on June 30, 1991, defendants filed suit against the debtor in the Superior Court of Puerto Rico, Arecibo

Part. Due to the debtor's filing of the bankruptcy petition, defendants appeared before the Bankruptcy Court and sought a determination that the contract had been terminated pre-petition; the Bankruptcy so decided on August 22, 1991. Pursuant to an appeal by the debtor, this Court affirmed the Bankruptcy Court's determination that the contract had been terminated pre-petition. The First Circuit Court of Appeals dismissed the debtor's appeal.

Defendants filed a proof of an unsecured claim in the bankruptcy case in the amount of $1,650,449.16 on November 15, 1991, for "moneys received by debtor for [defendants] due to services rendered to outpatients and in-patients and those services were not rendered by debtor." While the appeals process was pending, debtors sought an order in the Superior Court of Arecibo for the turnover of the hospital facilities, which was granted by said court; defendants took possession of the facilities on January 22, 1992. Defendants have been in control of the day-to-day management of the facilities since that time.

On February 14, 1994, the bankruptcy case was converted to Chapter 7 and Carlos Rodriguez Quesada was appointed the Chapter 7 trustee on February 24, 1994. The trustee filed the adversary proceeding at issue in this appeal on December 29, 1995, seeking the sum of $8,204,494.48 from defendants, plus interest since 1991, as well as attorneys' fees and costs.

Procedural Background

This Court has jurisdiction to entertain this appeal pursuant to 28 U.S.C. § 158(a). Appellant trustee did not

consent to jurisdiction by the Bankruptcy Appellate Panel as required under 28 U.S.C. § 158(b)(1).

The Bankruptcy Court determined that 11 U.S.C. §§ 106(a) and 106(b) were unconstitutional abrogations of a state's Eleventh Amendment immunity and thus would not be applied by the Court to determine whether DOH and AFASS had waived their Eleventh Amendment immunity. The Bankruptcy Court stated, without deciding, that "[t]he trustee's suit against the defendants is arguably a compulsive counterclaim pursuant to Fed.R.Civ.P. 13(a) as it arises out of the same transaction or occurrence that is the subject matter of the defendants' claim against the estate." **(Docket # 7, page 79).**

In its decision dismissing the adversary proceedings, the Bankruptcy Court held that the U.S. Supreme Court's decision in *Seminole Tribe of Florida v. Florida*, 517 U.S. 44, 116 S.Ct. 1114, 134 L.Ed.2d 252 (1996), where the Court held that Congress could not abrogate the States' Eleventh Amendment immunity pursuant to Article I and could only do so pursuant to the Fourteenth Amendment, mandated a finding that Congress' abrogation of the States' Eleventh Amendment immunity under § 106(a) was unconstitutional.

Accordingly, the Bankruptcy Court determined that 11 U.S.C. § 106(b) must also fall because no meaningful distinction could be made between § 106(a)'s abrogation language and § 106(b)'s waiver language. Citing *In re C.J. Rogers*, 212 B.R. 265 (E.D.Mich.1997), the Bankruptcy Court agreed with that court's determination that "if Congress cannot abrogate a state's right to sovereign immunity, then Congress cannot provide for a conditional

waiver, which amounts to language of abrogation, either." **(Docket # 7, page 77).**

Finding that §§ 106(a) and 106(b) were unconstitutional, the Bankruptcy Court determined that the Commonwealth of Puerto Rico had not voluntarily waived its Eleventh Amendment immunity through its actions in the instant case. The Court found that the filing of the proof of claim only waived the Commonwealth's sovereign immunity with respect to the adjudication of that claim. To that end, it stated that "to the extent that the defendants are claiming against the debtor's estate, the trustee may object to the claim and seek to set-off, up to the amount of the defendants' claim, the sums which the trustee alleges are owed to the estate. The trustee may not, however, seek to obtain an affirmative money judgment against the defendants in federal court without the consent of the Commonwealth of Puerto Rico." **(Docket # 7, page 81).**

The trustee appealed the Bankruptcy Court's dismissal of the adversary proceedings and has designated the following three issues on appeal:

> 1. The Bankruptcy Court committed reversible error in determining that the defendants, by filing a proof of claim did not waive their immunity under 11 U.S.C. § 106(b), and dismissed the complaint, instead of finding that the adversary proceeding constituted an objection to the claim in the form of a compulsory counterclaim as provided by Rule 13 of the Federal Rules of Civil Procedure applicable to bankruptcy proceedings under Rules 7002 and 7013 of the Bankruptcy Rules of Procedure.

2. The Bankruptcy Court committed reversible error when it found that the Commonwealth of Puerto Rico did not affirmatively waive its sovereign immunity with its active participation and conduct by filing contested matters and appeals and actively participating during the Chapter 11 and the adversary proceedings heard before the Bankruptcy Court.

3. The Bankruptcy Court erred in determining that Title 11, U.S.C., Sections 106(a) and 106(b) are unconstitutional.

Standard of Review

Rule 8013 of the Federal Rules of Bankruptcy Procedure provides that a reviewing court may affirm, modify or reverse a bankruptcy court's judgment, order, or decree, or it may remand with instructions for further proceedings. Fed.R.B.P. 8013.

The Bankruptcy Court's findings of fact shall be upheld unless they are clearly erroneous, and the Bankruptcy Court's conclusions of law shall be reviewed *de novo. T.I. Federal Credit Union v. DelBonis*, 72 F.3d 921, 928 (1st Cir.1995). This standard is the same as an appellate court's review of a district court order. *In re Savage Industries*, 43 F.3d 714, 719 (1st Cir.1994).

Applicable Law/Analysis

Section 106(a) – An Abrogation of the States' Eleventh Amendment Immunity

Title 11, § 106(a) as amended provides, in relevant part, that "[n]otwithstanding an assertion of sovereign

immunity, sovereign immunity is abrogated as to a governmental unit to the extent set forth in this section with respect to the following: (1) Section . . . 542 . . . of this title. . . . " Section 106(a) is a blanket abrogation clause, through which Congress has clearly stated that it seeks to void states' Eleventh Amendment immunity under various provisions of the Bankruptcy Code. *See generally,* Teresa K. Goebel, *In the Aftermath of Seminole: Waiver of Sovereign Immunity under Section 106(b) of the Bankruptcy Code,* 15 Bankr.Dev.J. 151 (1998); Joseph F. Riga, *State Immunity in Bankruptcy After Seminole Tribe v. Florida,* 28 Seton Hall L.Rev. 29 (1997); Justin V. Switzer, *Did They Really Think This Over? Seminole Tribe v. Florida and the Bankruptcy Code,* 34 Hous.L.Rev. 1243 (1997).

In light of the Supreme Court's decision in *Seminole Tribe, supra,* most courts that have addressed § 106(a)'s constitutionality have found that it is an unconstitutional abrogation of states' Eleventh Amendment immunity.[1] In fact, one commentator has noted that "[t]he courts that have found § 106(a) to be constitutional are the few dissenters among a majority of courts which have enacted the rationale of Seminole to find that Congress was not

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[1] The Eleventh Amendment provides: "The Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens or Subjects of any Foreign State." U.S. Const. amend. XI. Although by its terms, the Eleventh Amendment does not prohibit suits against a State by its own citizens, the Supreme Court has held that its reach extends to suits instituted against a state by its own citizens. *See Edelman v. Jordan,* 415 U.S. 651, 662-63, 94 S.Ct. 1347, 39 L.Ed.2d 662 (1974) (collecting cases).

acting pursuant to a valid exercise of power when it enacted § 106(a)." Katrina A. Kelly, *In the Aftermath of Seminole: Waiver of Sovereign Immunity under Section 106(b) of the Bankruptcy Code*, 15 Bankr.Dev.J. 151, 167 (1998). This Court has also held that Section 106(a) is unconstitutional in light of the Supreme Court's holding in *Seminole Tribe*. *In re Martinez*, 196 B.R. 225 (D.P.R.1996) (Pieras, J.). In that decision, the Court held that the Supreme Court's holding in *Seminole Tribe* mandated the conclusion that § 106(a) was "an unconstitutional violation of States' right to sovereign immunity protected by the Eleventh Amendment." 196 B.R. at 230.

The few courts that have found § 106(a) constitutional did so after determining that contrary to the statute at issue in *Seminole Tribe*, which was enacted pursuant to Congress' Article I powers, § 106(a) was enacted pursuant to Congress' faculties under the Fourteenth Amendment and thus did not come within the purview of the Court's holding in *Seminole Tribe*. *See, In re Southern Star Foods, Inc.*, 190 B.R. 419 (Bankr.E.D.Okl.1995) (holding that Congress had enacted § 106(a) pursuant to § 5 of the Fourteenth Amendment which would make it a permissible abrogation of Eleventh Amendment immunity, as reaffirmed by the Supreme Court in *Seminole Tribe*). *See also In re Straight*, 209 B.R. 540 (D.Wy.1997); *In re Burke*, 203 B.R. 493 (Bankr.S.D.Ga.1996); *In re Headrick*, 200 B.R. 963 (Bankr.S.D.Ga.1996).

This court, however, agrees with Judge Pieras' interpretation regarding the constitutionality of § 106(a), finding that pursuant to the Supreme Court's determination in *Seminole Tribe*, § 106(a)'s blanket abrogation of states' sovereign immunity is unconstitutional. Furthermore, we

find the bankruptcy court's determination in *In re NVR, L.P.*, 206 B.R. 831 (Bankr.E.D.Va.1997), that § 106 of the Bankruptcy Code was not enacted pursuant to Section 5 of the Fourteenth Amendment, to be persuasive. 206 B.R. at 843. The *NVR* court found that Congress did not identify Section 5 of Fourteenth Amendment as the source of authority for enacting § 106 and that significantly, there is nothing about the Act that connects it to the Fourteenth Amendment's recognized aims. *Id.* at 840. We agree with said court, as well as with the Sixth Circuit Court of Appeals: "If we were to say that an act is valid if it is rationally related to achieving equal protection of the laws, then § 5 becomes a license to Congress to pass any sort of legislation whatsoever." *Wilson-Jones v. Caviness*, 99 F.3d 203, 209 (6th Cir.1996). *See also In re Sacred Heart Hospital of Norristown*, 133 F.3d 237, 244 (3d Cir.1998); *In Matter of Estate of Fernandez*, 123 F.3d 241 (5th Cir.1997).

Because we find that Congress enacted § 106(a) pursuant to its Article I powers, rather than pursuant to its faculties under the Fourteenth Amendment, we must also find that § 106(a) is an unconstitutional abrogation of the states' Eleventh Amendment immunity. We thus affirm the Bankruptcy Court's holding, insofar as it determined that § 106(a) is unconstitutional. Our holding that § 106(a) is unconstitutional does not end the inquiry, however. We must now turn to § 106(b) to determine whether it, too, is an unconstitutional abrogation of states' sovereign immunity, or whether, instead, it is a valid waiver provision.

Section 106(b) – Provision Setting Conditions for Waiver of Sovereign Immunity

Section 106(b) provides that "[a] governmental unit that has filed a proof of claim in the case is deemed to have waived sovereign immunity with respect to a claim against such governmental unit that is property of the estate and that arose out of the same transaction or occurrence out of which the claim of such governmental unit arose." 11 U.S.C. § 106(b).

A commentator has noted that "[t]he congressional purpose behind effecting a waiver of sovereign immunity through a state's filing of a proof of claim was to prevent the inequity of allowing a state to receive a distribution from the bankruptcy estate without subjecting itself to liability within the scope of compulsory counterclaims." Kelly, *supra*, at 170. She has also noted that "[t]he requirement that the estate's claim be transactionally related to the governmental unit's claim is a reflection of the tension between the unfairness which would result if the state was not subjected to this limited liability and the unfairness which would result if the state could be subjected to unlimited liability." *Id.*

There is a split of authority regarding whether § 106(b) is an abrogation provision, which would render it invalid along with § 106(a), or a waiver provision, which would be permitted under the rationale of *Seminole Tribe*.

On the one hand, some courts have found that the waiver language of § 106(b) is also an invalid abrogation of states' sovereign immunity. For example, the *C.J. Rogers* court found that Congress' waiver language in

§ 106(b) was "simply a subterfuge to circumvent the 'no abrogation' doctrine and thereby, do indirectly what Congress may not now . . . do directly." *C.J. Rogers*, 212 B.R. at 271. It thus found that the waiver language in § 106(b) was the functional equivalent of the abrogation language contained in § 106(a):

> Put simply, whether Congress says "abrogate" or "deem to be waived" it clearly intends abrogation because either phrase has the same substantive and practical effect, namely Congress alone is determining when States will be subject to suit. Accordingly, the Court finds that Congress has expressed a clear intent to abrogate state sovereign immunity in § 106(b).

Id.

The Fourth Circuit Court of Appeals had earlier reached a similar conclusion. In *In re Creative Goldsmiths of Washington, D.C., Inc.*, 119 F.3d 1140 (4th Cir.1997), the Court found that:

> [b]ecause 11 U.S.C. § 106(a) purports to abrogate state immunity also for § 106(b), our analysis [regarding Congress' intent to abrogate under § 106(a)] likewise applies to § 106(b). But even the language of 11 U.S.C. § 106(b) itself – that a state is "deemed to have waived sovereign immunity" – amounts to language of abrogation.

Id. at 1147. *See also NVR*, 206 B.R. at 839 ("[I]nsofar as Congress undertook in revised . . . § 106(b) . . . to displace or to modify the meaning ascribed to the Eleventh Amendment by the courts, its endeavor must be deemed

an attempted abrogation of the states' constitutional immunity").

On the contrary, some courts have distinguished between § 106(a)'s abrogation language and § 106(b)'s waiver language, finding that § 106(b) is valid because it requires affirmative action on the part of a state before its Eleventh Amendment immunity can be deemed to be waived, contrary to § 106(a) which provided for a blanket abrogation regardless of the state's conduct.[2]

In a recent decision, the Tenth Circuit Court of Appeals held that the abrogation language in § 106(a) is quite different from the waiver language contained in § 106(b). *In re Straight*, 143 F.3d 1387 (10th Cir.1998). To that end, it stated:

> Unlike § 106(a) which purports to abolish sovereign immunity across the board, § 106(b) leaves the choice to the governmental unit. It can eschew bankruptcy relief and retain its immunity, or it can doff the protective cloak and join the ranks of creditors seeking the benefits from the debtor's estate. That choice is not constitutionally profound, and it is in accord with one of the fundamental principles of bankruptcy.

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[2] The Fourth Circuit remains the only circuit court of appeals to declare § 106(b) unconstitutional. While only the Tenth Circuit, *see infra*, has expressly upheld the constitutionality of § 106(b), several others have implicitly upheld its waiver provision based upon the Supreme Court's holding in *Gardner v. New Jersey*, 329 U.S. 565, 67 S.Ct. 467, 91 L.Ed. 504 (1947). *See Texas v. Walker*, 142 F.3d 813, 820-23 (5th Cir.1998); *In re Platter*, 140 F.3d 676, 678-80 (7th Cir.1998); and *In re White*, 139 F.3d 1268, 1271 (9th Cir.1998).

Id. at 1392. It grounded its decision not only in a constitutional analysis of the language of § 106(b) in light of the Court's decision in *Seminole Tribe,* but also in the basic principle underpinning the bankruptcy system, equity. It stated:

> We start from the general premise that the law of bankruptcy is founded upon principles of equity. That foundation requires all persons or entities in the same class to be treated alike. Thus, creditors coming to the bankruptcy court for relief expect they will fare no better or worse than others of their stature. Moreover, the whole concept of bankruptcy cannot succeed without a careful application of these principles and a forthright dedication to their significance.

Id. at 1389.

We agree wholeheartedly with the Tenth Circuit's interpretation of the waiver language contained in § 106(b). There is a distinct difference between a blanket abrogation, such as is contained in § 106(a), which does not premise the absence of Eleventh Amendment immunity on any action by the state, and the waiver language of § 106(b), which premises the loss of Eleventh Amendment immunity upon an affirmative action by the state to take advantage of, and participate in, the bankruptcy process. It would be highly inequitable for a state to be able to reap the benefits of filing a proof of claim and receiving monies from the estate, if unlike all other creditors, it would not be liable for any amounts that it owed to the estate.

We believe that the language contained in § 106(b), which limits the waiver to a claim "that arose out of the

same transaction or occurrence out of which the claim of such governmental unit arose", clearly delineates the scope of the waiver contained in the section and limits said waiver in an equitable fashion. Because the state has chosen to enter the bankruptcy arena in order to vindicate its rights as a creditor, it must take the good with the bad, and face the possibility that its liability to the estate may exceed the amounts it claims in its proof of claim if they stem from the same transaction or occurrence.

We thus find that § 106(b) does not constitute an unconstitutional abrogation of a state's Eleventh Amendment immunity. Rather, we find that it is a strictly delineated valid waiver provision, where the waiver of immunity is effected by a state's voluntary participation in the bankruptcy process, rather than by a blanket determination by Congress that immunity is abrogated regardless of a state's actions. The Bankruptcy Court's determination that § 106(b) is an unconstitutional abrogation of a state's Eleventh Amendment immunity is thus hereby **REVERSED**.

Whether the proof of claim and the estate's claim are covered by § 106(b)

Appellant would have this Court decide that the Bankruptcy Court committed reversible error when it refused to find that the proof of claim filed by DOH/AFASS and the claim against it by the trustee arose from the same transaction or occurrence and thus DOH/AFASS waived its sovereign immunity under the statute. The Bankruptcy Court did not decide this issue because it

had held, as threshold matter, that § 106(b) was unconstitutional. We thus will not address the issue of whether the proof of claim and the trustee's claim arise out of the same transaction or occurrence and thus fall within the scope of § 106(b) and instead **REMAND** this issue for elucidation by the Bankruptcy Court in light of our holding that § 106(b) is constitutional.

Conclusion

Pursuant to the above discussion, the Bankruptcy Court's decision is **AFFIRMED IN PART** and **REVERSED IN PART**. This action shall be **REMANDED** for further proceedings consistent with this Opinion and Order. Judgment will be entered accordingly.

SO ORDERED.

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF PUERTO RICO

In re:	
ARECIBO COMMUNITY HEALTH CARE, INC.	Case No. 91-04594 (GAC)
	Chapter 7
Debtor	Adv. No. 95-0150 (GAC)
CARLOS E. RODRIGUEZ QUESADA,	
Plaintiff	
v.	
COMMONWEALTH OF PUERTO RICO DEPARTMENT OF HEALTH, ADMINISTRATION OF HEALTH SERVICES,	
Defendants	

DECISION AND ORDER

(Filed Apr. 16, 1998)

Before the Court is a motion for reconsideration of order and judgment under Rule 59(e) filed by the plaintiff, Arecibo Community Health Care, Inc., (ACHI) by its trustee, Mr. Carlos Rodriguez Quesada (hereinafter "plaintiff") (dkt. #44) and an opposition to the motion filed by the Puerto Rico Department of Health ("Department") and Administration of Health Services ("AFASS")

(collectively "defendants") (dkt. #50). The Court heard argument on the matter on December 16, 1997.

By Decision and Order, entered on October 21, 1997, the Court granted a motion to dismiss by the defendants and dismissed the adversary proceeding for lack of jurisdiction (dkt. #42). Judgment was entered on October 21, 1997. The Court concluded that 11 U.S.C. §§ 106(a) and 106(b) are unconstitutional and that the plaintiff could not avail himself of these sections to invalidate the Commonwealth of Puerto Rico's Eleventh Amendment constitutional right to sovereign immunity. The Court concluded that the Commonwealth had not waived its sovereign immunity. Finally, the Court concluded that by filing a proof of claim, the Commonwealth had only waived sovereign immunity with respect to adjudication of the claim.

In the motion for reconsideration, the plaintiff argues that a bankruptcy court does not have the authority to determine the constitutionality of a statute; that AFASS is not an instrumentality of the Commonwealth of Puerto Rico and therefore not immune to suit under the Eleventh Amendment; that the Commonwealth waived its immunity to suit; and that if the Court lacks subject matter jurisdiction over this adversary proceeding, then the Court lacks jurisdiction in all other bankruptcy proceedings concerning the Commonwealth and all orders affecting the Commonwealth must be vacated.

The defendants argue that the Court properly determined that 11 U.S.C. §§ 106(a) and 106(b) are unconstitutional; that they did not formally consent to suit in

federal court; that they did not waive sovereign immunity; and that AFASS is not a defendant, because it was not served with the summons and compliant in this action.

DISCUSSION

In the Court's previous Decision and Order (dkt. #42), the Court discussed the background of the dispute between these parties, and hereby incorporates that discussion in its entirety.

The plaintiff argues that whether Congress acted beyond its constitutional power in enacting 11 U.S.C. § 106, must be decided before a tribunal exercising the judicial power of the United States under Article III of the Constitution. This is an intriguing argument, although not compelling. Some bankruptcy courts have indicated that they do not have the authority to determine the constitutionality of a statute. See e.g. *in re Headrick*, 203 B.R. 805, 808 (Bankr. S.D.Ga 1996). A Bankruptcy Court for the District of Nebraska has indicated that bankruptcy courts in that District do not have the authority to determine the constitutionality of a statute. See *In re Best Refrigerated Express, Inc.*, 168 B.R. 978, 981 (Bankr. D.Neb. 1994). Some bankruptcy courts have issued decisions implying that they had jurisdiction to determine the constitutionality of a statute. See *In re ABEPP Acquisition Corp.*, 215 B.R. 513 (6th Cir. BAP 1997); and *In re J.F.D. Enterprises, Inc.*, 183 B.R. 342 (Bankr. D.Mass. 1995). Still other bankruptcy courts have considered whether there is authority in the jurisdiction, which lends guidance to how the court should rule in a determination of the

constitutionality of the statute in question. If authority exists, the court may make the determination. See *in re Medill*, 119 B.R. 685, 688 (Bankr. D.Minn. 1990) (although issue of constitutionality of state statute was dispositive and state Supreme Court had never ruled on the issue, since prior state Supreme Court cases provided guidance for bankruptcy court's resolution of issue, certification of issue to state Supreme Court was not warranted). Finally, a number of bankruptcy courts have exercised jurisdiction. See e.g. *In re NVR L.P.*, 206 B.R. 831, 839 (Bankr. E.D.Va 1997) (concluding that 11 U.S.C. § 106(b) and § 106(c) are unconstitutional); *In re Mueller*, 211 B.R. 737, 740 (Bankr. D.Mont. 1997) (Congress' efforts under 11 U.S.C. § 106(a) to abrogate state sovereign immunity are void as unconstitutional); *In re Rose*, 215 B.R. 755, 758 (Bankr. W.D.Mo. 1997) (11 U.S.C. § 106(b) is unconstitutional to the extent that it dictates the circumstances constituting a waiver of immunity on the part of a state); and *In re Charter Oak Assoc.*, 203 B.R. 17, 21 (Bankr. D.Conn. 1996) (11 U.S.C. § 106(a) can not constitutionally confer federal jurisdiction to support money judgment against State Department of Social Services). Some courts may have exercised jurisdiction, perhaps because the issue was not specifically raised by the litigant.

If this Court does not have the authority to determine the constitutionality of 106(a) and (b), it would still have the ability to certify that issue to the United States District Court for the District of Puerto Rico, along with proposed conclusions of law. See *In re Headrick*, 203 B.R. 805, 808 n.5 (Bankr. S.D.Ga 1996). The District Court would then review the proposed conclusions and make a determination. Also, the plaintiff may appeal this Court's

legal conclusions that 106(a) and (b) are unconstitutional and obtain *de novo* review. If the plaintiff opts out of the Bankruptcy Appellate Panel, the plaintiff may obtain review and a determination from the United States District Court as to the constitutionality of the statute and as to this Court's jurisdiction to consider the constitutionality of an act of Congress. Thus, a determination by this Court at this point in the proceedings, that it does not have the authority to determine the constitutionality of § 106(a) and § 106(b), would further delay these proceedings without satisfying any objective. This Court expressly rejects plaintiff's argument that Congress enacted 11 U.S.C. §§ 106(a) and 106(b) pursuant to a valid exercise of power.

Section 2403 of title 28 provides that:

> [i]n any action, suit or proceeding in a court of the United States to which the United States or any agency, officer or employee thereof is not a party, wherein the constitutionality of any Act of Congress affecting the public interest is drawn in question, the court shall certify such fact to the Attorney General, and shall permit the United States to intervene for presentation of evidence, if evidence is otherwise admissible in the case, and for argument on the question of constitutionality. . . .

28 U.S.C. § 2403. Pursuant to this section, the Court shall certify the existence of the constitutional challenge to 11 U.S.C. § 106(a) and 106(b) to the United States Attorney General. Other courts have held that compliance with this statute is not a jurisdictional requirement. See *in re J.F.D. Enterprises, Inc.*, 183 B.R. 342, 355 (Bankr. D.Mass. 1995) and the citations therein at 355 n.20. Accordingly, the

Court will direct the Clerk to provide notice to the United States of the Orders and judgment and allow the United States the opportunity to intervene and appeal.

The plaintiff argues in the motion for reconsideration that AFASS is not an instrumentality of the Commonwealth of Puerto Rico and therefore not immune from suit under the Eleventh Amendment. The defendants argue that AFASS was not served with the summons and the complaint and that the Court does not have jurisdiction over it. The Court has reviewed the exhibit submitted by the trustee at the hearing held on December 16, 1997 and concludes that AFASS was properly served with the summons and complaint.

In determining whether an agency is an instrumentality of the Commonwealth, the First Circuit Court of Appeals has considered such factors as: (1) whether the agency or entity is attached to a Department of the Commonwealth; (2) whether the Board of Directors is appointed by the Governor; (3) whether the entity is responsible for carrying out the public policy of the Commonwealth; (4) whether the property of the entity is exempt from taxation; (5) whether the entity can accept donations on behalf of the Commonwealth; (6) whether a judgment against the entity would be satisfied from the Commonwealth's general budget; (7) the source of revenue for the entity; and (8) whether the entity may sue and be sued in the Courts of Puerto Rico. See *Culebras Enterprises Corp. v. Rivera Rios*, 813 F.2d 506, 517 (1st Cir. 1986) and *San Juan Dupont Plaza Hotel v. Tourism Company of Puerto Rico*, 888 F.2d 940, 943 (1st Cir. 1989).

In the present case, the Court finds that the plaintiff has adequately described a number of AFASS's powers pursuant to 24 L.P.R.A. § 337(d) in his motion for reconsideration at pages 19-20 (dkt. #44). The Court also concludes that AFASS is "attached to the Health Department." See 24 L.P.R.A. § 337c.(a). The powers of AFASS are exercised by the Secretary of the Department of Health ("Secretary") and the rules and regulations of AFASS must be approved by the Governor. 24 L.P.R.A. § 337c.(b). The director of AFASS is also appointed by the Secretary, with the approval of the Governor. 24 L.P.R.A. § 337c.(c). The Court concludes that the Commonwealth exercises significant control over AFASS.

AFASSS was created to integrate and coordinate health services for the people of Puerto Rico by administering and operating health facilities. See 24 L.P.R.A. § 337. AFASS has a "health fund" which is "devoted exclusively to attend to any needs related to the people's health . . . " 24 L.P.R.A. § 337j-1. The health fund consists of, among other things, moneys contributed to the municipalities of the Commonwealth for health services, funds from the United States Government, Commonwealth appropriations and "donations and gifts to the Commonwealth to attend to health problems." 24 L.P.R.A. § 337j-1. The Court concludes that AFASS is responsible for carrying out the public policy of the Commonwealth and that AFASS receives money from and on behalf of the Commonwealth. Moreover, AFASS is exempt from taxation. 24 L.P.R.A. § 337i. Based on these factors, this Court concludes that AFASS is an instrumentality of the Commonwealth of Puerto Rico and thus is protected from suit by the Eleventh Amendment.

The remainder of the plaintiff's arguments relate primarily to whether the Commonwealth of Puerto Rico waived its immunity to suit in this action. The plaintiff indicates that the Department has only mentioned the Eleventh Amendment on two instances and in this adversary the defendant's Eleventh Amendment defense was raised after two years of litigation and only after the defendants obtained new legal counsel. The plaintiff argues that the defendants waived their sovereign immunity by filing a proof of claim. The plaintiff also argues that prior to this adversary proceeding, the defendants participated in this bankruptcy case by filing a motion for relief from stay and by filing a motion to dismiss. The plaintiff argues that the defendants conduct in participating in this bankruptcy case and this adversary proceeding misled him into believing that the defendants were waiving their immunity to suit in federal court.

The Court previously found that the defendants made a prelude to a sovereign immunity defense in the first sentence of the answer to the complaint in which they stated that they were not waiving their right to sovereign immunity under the Eleventh Amendment. Numerous courts have held that a defense based on lack of subject matter jurisdiction may be raised at any time. See generally *In re Platter,* 1998 WL 138847 (7th Cir. 1998) (Eleventh Amendment immunity asserted for the first time on appeal); *In re Rose,* 214 B.R. 372 (Bankr. W.D.Mo. 1997) (Eleventh Amendment argument asserted after trial); and *In re Mueller,* 211 B.R. 737 (Bankr. D.Mont. 1997). This Court likewise concludes that an Eleventh Amendment immunity defense may be raised at any time. The real issue when the defense is asserted during

trial, after trial or on appeal is whether the governmental unit has waived the defense in some other manner.

This Court discussed the doctrine of waiver at length in the Decision and Order of October 21. The Court previously cited cases which concluded that a governmental entity only waived its immunity as to the adjudication of a claim by filing a proof of claim. Since the issuance of the Decision and Order, the Court notes that at least two other Courts have expressly reached this same conclusion. See *In re White*, 1998 WL 125092 *2-3 (9th Cir. 1998) (governmental unit's filing of proof of claim only waives immunity with respect to adjudication of the claim) in *In re Rose*, 215 B.R. 755, 759-62 (Bankr. W.D.Mo. 1997). This Court declines to conclude that a governmental unit has completely waived its sovereign immunity by simply filing a claim in a bankruptcy case.

The Court concludes that the plaintiff has not presented any new evidence or arguments in the motion for reconsideration which would lead the Court to conclude that the defendants waived their Eleventh Amendment immunity through their conduct. The plaintiff discusses the case of *Futura Development of Puerto Rico, Inc. v. Estado Libre Asociado de Puerto Rico*, 962 F.Supp. 248 (D.P.R. 1997) and argues that the decision supports a finding of waiver in the present case. In *Futura Development*, the Court found that the Commonwealth had waived its immunity to suit. In that case, however, the Court found that after the plaintiff had obtained judgment against an instrumentality of the Commonwealth in federal court, the Commonwealth actively took steps to preclude the plaintiff from collecting the judgment. When *Futura Development* was decided, ten years had gone by since the

judgment had been entered. At one point the Court points out:

> [i]t is, however, the Commonwealth's course of conduct once the judgment against CDC became final that tips the balance in favor of plaintiff's argument and confirms any doubts which might have existed up to this point as to the Commonwealth's waiver.

Id. at 255. The Court later stated:

> [m]ore importantly, the foregoing facts illustrate that the Commonwealth vigorously supported CDC: it stood behind CDC in filing an action of questionable merit in this Court, and when that backfired and resulted in an adverse judgment of $12.3 million, it sought to preclude collection of the same.

Id. at 257.

The present case is unlike *Futura Development.* The defendants have participated in the bankruptcy to the extent that the Bankruptcy Code required their participation to take particular actions related to the debtor. For example, the defendants sought and obtained from the bankruptcy court a determination that their contract with the debtor had expired prepetition. The defendants would otherwise have been prohibited by the automatic stay of 11 U.S.C. § 362 from seeking the turnover of the debtor's hospital facilities in the Commonwealth courts. Whether or not the Commonwealth has Eleventh Amendment immunity, the Commonwealth is prohibited by 11 U.S.C. § 362 from violating the automatic stay. In the same way, had the defendants, after notice of the bankruptcy, failed to file a proof of claim, some courts would

find that the defendants' claim could be discharged just like the claim of any other unsecured creditor that fails to file a timely proof of claim. The defendants' immunity to suit does not necessarily translate into immunity from a discharge injunction. Furthermore, the fact that the defendants have responded to this Court's orders and appeared at the scheduled hearings does not suggest that the defendants have waived their immunity to suit. This Court does not conclude, as the plaintiffs have insisted, that the Commonwealth's campaign has been to "have its cake and eat it too."

The plaintiff places importance on the negotiations with the defendants to submit the dispute regarding their debt to a third party for determination of any amounts owed. The Court concludes, however, that the defendants did not agree that if a unresolvable dispute arose, that they would submit to the jurisdiction of the federal court to determine the amount owed. From the time that this action was filed, the defendants have asserted their Eleventh Amendment immunity.

The Court concludes, as it did before, that 11 U.S.C. §§ 106(a) and 106(b) are unconstitutional. The Court concludes that the Administration of Health Services is an instrumentality of the Commonwealth of Puerto Rico and thus immune from suit under the Eleventh Amendment. Finally, the Court concludes that the Commonwealth has not waived its immunity from suit. Accordingly, the plaintiff's motion for reconsideration will be denied.

ORDER

WHEREFORE IT IS ORDERED that the motion for reconsideration of order and judgment under Rule 59(e) filed by the plaintiff, Arecibo Community Health Care, Inc., by its trustee, Mr. Carlos Rodríguez Quesada (dkt. #44) is DENIED.

The Clerk shall notify all parties in interest of this order and shall notify a copy of the Decision and Order of October 21, 1997, the judgment of October 21, 1997 and this Decision and Order to the United States Attorney General so that the Attorney General may intervene and appeal the orders and judgment. The Court hereby extends the time for the United States to appeal this order an additional twenty (20) days pursuant to Fed.R.Bankr.P. 8002.

SO ORDERED.

San Juan, Puerto Rico this 13th day of April, 1998.

/s/ Gerardo A. Carlo
Gerardo A. Carlo
U.S. Bankruptcy Judge

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF PUERTO RICO

IN RE: ARECIBO COMMUNITY HEALTH CARE, INC. Debtor	CASE NO. 91-04594(GAC)
	CHAPTER 7
CARLOS E. RODRIGUEZ QUESADA Plaintiff V. COMMONWEALTH OF PUERTO RICO DEPARTMENT OF HEALTH, ADMINISTRATION OF HEALTH SERVICES, Defendants	ADV. NO. 95-0150

JUDGMENT

(Filed Oct. 21, 1997)

Upon the Decision and Order entered by the Honorable Gerardo A. Carlo on October 21, 1997, it is now

ADJUDGED AND DECREED that judgment be and is hereby entered dismissing the instant adversary proceedings.

San Juan, Puerto Rico, this 21st day of October 1997.

/s/ [Illegible]
CELESTINO MATTA-MENDEZ
CLERK OF THE COURT

cc: debtor; Igor J. Dominguez;
UST; Carlos Rodriguez Quesada;
Hector Marquez; Isabel Abislaiman;

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF PUERTO RICO

In re:	
ARECIBO COMMUNITY HEALTH CARE, INC.,	Case No. 91-04594 (GAC)
Debtor	Chapter 7
CARLOS E. RODRIGUEZ QUESADA,	
Plaintiff,	Adv. No. 95-0150 (GAC)
v.	
COMMONWEALTH OF PUERTO RICO DEPARTMENT OF HEALTH, ADMINISTRATION OF HEALTH SERVICES,	
Defendants	

DECISION AND ORDER

(Filed Oct. 21, 1997)

Before the Court is a motion to dismiss filed by the Puerto Rico Department of Health and Administration of Health Services, both instrumentalities of the Commonwealth of Puerto Rico (hereinafter "defendants") (dkt. #31) and the plaintiff's opposition (dkt. #36). In the motion to dismiss, the defendants argue that the Court lacks jurisdiction over this dispute based on their right to sovereign immunity. The defendants argue that they have not consented to suit in federal court and thus that the

suit is barred by the Eleventh Amendment to the United States Constitution. The plaintiff admits that the ability of Congress to abrogate a State or Commonwealth's Eleventh Amendment immunity to suit may have been severely limited by the Supreme Court's decision in *Seminole Tribe of Florida v. Florida*, 116 S.Ct. 1114 (1996), but argues that the Commonwealth of Puerto Rico has waived its sovereign immunity in this case because it has filed a proof of claim and based on other acts.

BACKGROUND

The dispute between the debtor and the defendants began prepetition when the defendants terminated the contract with debtor for the operation of the Arecibo Regional Hospital. On June 30, 1991, the defendants filed suit against the debtor in the Superior Court of Puerto Rico, Arecibo Part. On July 2, 1991, the debtor filed a voluntary petition under Chapter 11 of the Bankruptcy Code. The defendants sought a determination from the Bankruptcy Court that the contract between the debtor and defendants had been terminated prepetition. The Bankruptcy Court determined by order of August 22, 1991, that the contract was terminated prepetition. The debtor appealed this decision. The defendants filed proof of an unsecured claim in the amount of $1,650,449.16 on November 15, 1991. On December 18, 1991, the United States District Court for the District of Puerto Rico affirmed the Bankruptcy Court's determination that the contract between the debtor and the defendants was terminated prepetition. The debtor again appealed. On November 23, 1993, the United States Court of Appeals for the First Circuit dismissed the debtor's appeal.

While the appeals process was pending, the defendants sought an order in the Superior Court for turnover of the hospital facilities. The Superior Court of Puerto Rico, Arecibo Part, granted this relief and the defendants took possession of the facilities on January 22, 1992. The defendants have been in control of the day-to-day management of the facilities since that time.

This case was converted to Chapter 7 on February 14, 1994. Carlos Rodriguez Quesada was appointed the Chapter 7 trustee on February 24, 1994. The trustee filed this adversary proceeding on December 29, 1995. The trustee seeks the sum of $8,204,494.48 from the defendants, plus interest since 1991, attorney's fees and the costs of litigation.

DISCUSSION

The Court initially notes that the trustee's action is titled as an action for turnover of property of the estate pursuant to 11 U.S.C. § 542, which would be a core proceeding pursuant to 128 U.S.C. 157(b)(2)(E). The trustee argues that the complaint does not pray for damages, but then states in paragraph eighteen of the answer to the motion to dismiss that the only controversy before the court involves a determination of the amounts owed between the parties. The Court concludes that some part of the relief requested by the trustee clearly relates to damages for breach of contract or contract related monetary claims, which are in the nature of non-core proceedings. Specifically, paragraphs fourteen through twenty do

not relate to turnover of property or the value of property, but rather relate to damages for breach of contract or contract related claims.

The Eleventh Amendment to the U.S. Constitution provides that "[t]he Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens or Subjects of any Foreign State." This section has also been interpreted to bar a suit in federal court against a State, by a citizen of the State. See *Hans v. Louisiana*, 10 S.Ct. 504 (1890). Historically, pursuant to the prohibition against suit found in the Eleventh Amendment, a state could only be sued in federal court with its consent. *Ford Motor Co. v. Department of Treasury of Indiana*, 65 S.Ct. 347 (1945).

On October 22, 1994, Congress enacted the Bankruptcy Reform Act of 1994, Publ.L.No. 103-394, 108 Stat. 4106 (1994), in which it amended 11 U.S.C. § 106. Congress specifically indicated that the amendments to § 106, apply with respect to cases commenced before, on, and after the date of the enactment of the Reform Act. Section 106, as amended, provides in relevant part:

> (a) Notwithstanding an assertion of sovereign immunity, sovereign immunity is abrogated as to a governmental unit to the extent set forth in this section with respect to the following:
>
> (1) Section . . . 542 . . . of this title.
>
> . . .
>
> (b) A governmental unit that has filed a proof of claim in the case is deemed to have waived sovereign immunity with respect to a

> claim against such governmental unit that is property of the estate and that arose out of the same transaction or occurrence out of which the claim of such governmental unit arose.

11 U.S.C. § 106. Subsection a, on its face, abrogates a State's Eleventh Amendment right to sovereign immunity for actions brought, among others, pursuant to 11 U.S.C. § 542. Subsection b conditionally abrogates a State's Eleventh Amendment right to sovereign immunity when the State has filed a proof of claim in the bankruptcy case and the claim against the State involves the same transaction or occurrence that is the subject of the proof of claim by the State.

Since the Amendment of § 106, the United States Supreme Court decided *Seminole Tribe of Florida v. Florida*, 116 S.Ct. 1114 (1996). In *Seminole*, the Court held that Congress does not have the authority pursuant to the Indian Commerce Clause, U.S. Const. Art. 1, § 8, cl. 3, to abrogate the States' Eleventh Amendment right to sovereign immunity from suit. The Court explicitly overturned the decision of *Pennsylvania v. Union gas Co.*, 109 S.Ct. 2273 (1989), in which the Court had held that pursuant to the Interstate Commerce Clause, U.S. Const. Art. 1, § 8, cl. 3, Congress could abrogate a State's Eleventh Amendment right to sovereign immunity. *Seminole*, 116 S.Ct. at 1128. In *Seminole*, the Court held that Congress could not abrogate a State's Eleventh Amendment right to sovereign immunity from suit under any power, except the Fourteenth Amendment. *Id.* at 1125.

Prior to the Supreme Court's decision in *Seminole*, the United States Court of Appeals for the Seventh Circuit issued a decision in *In Matter of Merchants Grain, Inc.*, 59

F.3d 630 (7th Cir. 1995), in which the Seventh Circuit held that Congress had the authority pursuant to the bankruptcy Clause, U.S. Const. Art. 1, § 8, cl. 4, to abrogate a State's Eleventh Amendment right to sovereign immunity pursuant to 11 U.S.C. § 106(a). The Seventh Circuit's decision in *Merchants Grain* was appealed to the United States Supreme Court. In *Ohio Agricultural Commodity Depositors Fund v. M. Mahern*, 116 S.Ct. 1411 (1996), the Supreme Court vacated the judgment in *Merchants Grain* and remanded the case to the U.S. Court of Appeals for the Seventh Circuit for further consideration in light of the Supreme Court's decision in *Seminole*.

Based on the Supreme Court's decision in *Seminole* and the reversal of *Merchant's Grain*, the U.S. Court of Appeals for the Fourth Circuit recently concluded held [sic] that "Congress has no authority under the Bankruptcy Clause, U.S. Const. art. I, § 8, cl. 4, to abrogate state sovereign immunity in federal courts." *In re Creative Goldsmiths of Washington, D.C., Inc.*, 119 F.3d 1140, 1145 (4th Cir. 1997). The Court held that "Congress' effort to abrogate the states' Eleventh Amendment immunity through its 1994 enactment of 11 U.S.C. § 106(a) is unconstitutional and ineffective. *Id.* at 1147 (citing *Seminole*, 116 S.Ct. at 1131-32). The Fifth Circuit Court of Appeals has also concluded that 11 U.S.C. § 106(a) is unconstitutional. *In the Matter of Fernandez*, 1997 WL 570353 *5 (5th Cir. (La.) 1997). This Court notes that a decision issued by the United States District Court for the District of Puerto Rico, likewise concludes that 11 U.S.C. § 106(a) is an unconstitutional violation of a State's right to Eleventh Amendment sovereign immunity. See *In re Martinez*, 196 B.R. 225, 230 (D.P.R. 1996).

The Court in *Creative Goldsmiths* also concluded that 11 U.S.C. § 106(b) is unconstitutional. *In re Creative Goldsmiths*, 119 F.3d at 1147. The United States District Court for the Eastern District of Michigan has reached the same conclusion, stating that "[t]he distinction that Congress has attempted to draw [between § 106(a) and § 106(b)], must fail because the intent to abrogate in section (a) and the intent to 'conditionally abrogate' in section (b) are in substance and function the same." *In re C.J. Rogers, Inc.*, 1997 WL 523299 at *6 (E.D. Mich. 1997). The Court reasoned that if Congress cannot abrogate a state's right to sovereign immunity under the Eleventh Amendment, then Congress cannot provide for a conditional waiver which amounts to language of abrogation, either. The Court concluded that "Congress did not enact 11 U.S.C. § 106(b) pursuant to its powers under the Fourteenth Amendment, and therefore, under *Seminole Tribe of Florida*, the Court must declare § 106(b) unconstitutional because [the enactment under] any other power of Congress would be invalid in these circumstances." *Id.* at *8.

Based on the holdings and reasoning of *Creative Goldsmiths* and *C.J. Rogers*, this Court concludes that 11 U.S.C. §§ 106(a) and (b) are unconstitutional and that the trustee may not avail himself of these sections to invalidate the Commonwealth of Puerto Rico's Eleventh Amendment constitutional right to sovereign immunity.

The only issue remaining is whether the Commonwealth of Puerto Rico has voluntarily waived its sovereign immunity. The U.S. Supreme Court has stated that:

> A State may effectuate a waiver of its constitutional immunity by a state statute or constitutional provision, or by otherwise waiving its

> immunity to suit in the context of a particular federal program. In each of these situations, we require an unequivocal indication that the State intends to consent to federal jurisdiction that otherwise would be barred by the Eleventh Amendment. As we said in *Edelman v. Jordan*, 415 U.S. 651, 673, 94 S.Ct. 1347, 1360, 39 L.Ed.2d 662 (1974), "[c]onstructive consent is not a doctrine commonly associated with the surrender of constitutional rights, and we see no place for it here."

Atascadero State Hosp. v. Scanlon, 105 S.Ct. 3142, 3145 n.1 (1985). "The test for determining whether a State has waived its immunity from federal-court jurisdiction is a stringent one." *Id.* at 3146. "A State waives its immunity and consents to suit in federal court: (1) by specific declaration or by act, such as filing a general appearance, or by the State becoming a plaintiff or an intervenor in the federal lawsuit." *In re C.J. Rogers, Inc.*, 1997 WL 523299 at *9 (citations omitted).

The Court concludes that the defendants have not formally consented to being sued in federal court for damages. The Puerto Rico legislature has not by statute waived the Commonwealth's immunity to suit for damages in federal court. Nor does the Constitution of Puerto Rico waive the Commonwealth's right to sovereign immunity. Likewise, the Commonwealth has not filed a general appearance in federal court, nor are the defendants, plaintiffs or intervenors in this action. Moreover, when the defendants answered the complaint in this adversary, the first sentence of their answer includes a statement that the defendants are not waiving their right

to sovereign immunity under the Eleventh Amendment by answering the complaint.

The defendants have, however, filed a proof of an unsecured claim seeking the sum of $1,650,449.16 for "moneys received by debtor for [defendants] due to service rendered to outpatients and in-patients and those services were not rendered by debtor." The claim relates to the contract between the debtor and defendants, which covered the debtor's administration of the Arecibo Regional Hospital. The trustee's suit against the defendants is arguably a compulsory counterclaim pursuant to Fed.R.Civ.P. 13(a) as it arises out of the same transaction or occurrence that is the subject matter of the defendants' claim against the estate. The Bankruptcy Code, as amended by the Reform Act of 1994, clearly provided for the waiver of a State's sovereign immunity under these circumstances. 11 U.S.C. § 106(b). Having found 11 U.S.C. § 106(b) unconstitutional, the question remains whether a cause of action, which could be deemed a compulsory counterclaim to the State's proof of claim, may be allowed to proceed under other principles.

The Court in *In re Creative Goldsmiths of Washington, D.C., Inc.*, 119 F.3d 1140, 1148 (4th Cir. 1997), based on what the Court termed "fundamental fairness of judicial process" stated that:

> to the extent a defendant's assertions in a state-instituted federal action, including those made with regard to a state-filed proof of claim in a bankruptcy action, amount to a compulsory counterclaim, a state has waived any Eleventh

> Amendment immunity against that counterclaim in order to avail itself of the federal forum.

Id. at 1148. This language suggests that an affirmative monetary judgment could be obtained against a State pursuant to a compulsory counterclaim, solely based on the State's filing of the proof of claim. This appears to be contrary to the U.S. Supreme Court's decision in *Gardner v. State of New Jersey*, 67 S.Ct. 467, *reh'g denied*, 67 S.Ct. 768 (1947).

In *Gardner*, the Supreme Court stated that:

> he who invokes the aid of the bankruptcy court by offering a proof of claim and demanding its allowance must abide the consequences of that procedure. If the claimant is a State, the procedure of proof and allowance is not transmitted into a suit against the State because the court entertains objections to the claim. The State is seeking something from the debtor. No judgment is sought against the State. The whole process of proof, allowance, and distribution is, shortly speaking, an adjudication of interests claimed in a res. It is none the less such because the claim is rejected in toto, reduced in part, given a priority inferior to that claimed, or satisfied in some way other than payment in cash. When the State becomes the actor and files a claim against the fund it waives any immunity which it otherwise might have had respecting the adjudication of the claim.

Gardner, 67 S.Ct. at 472 (citations omitted). The Supreme Court's pronouncement suggests that by filing a proof of claim, a State has only waived sovereign immunity with respect to the adjudication of the claim. Other courts have

reached this result. See *In re NVR L.P.*, 206 B.R. 831, 851 (Bankr. E.D.Va 1997) (holding that filing of a claim should at most be interpreted only as an express consent to the adjudication of that claim); *In re C.J. Rogers, Inc.*, 1997 WL 523299 *10 (E.D.Mich. 1997) and citations therein. This is also consistent with 11 U.S.C. § 106(c), which presently provides that "[n]otwithstanding any assertion of sovereign immunity by a governmental unit, there shall be offset against a claim or interest of a governmental unit any claim against such governmental unit that is property of the estate."

This Court concludes that the defendants' general participation in the debtor's bankruptcy case, including the filing of a proof of claim and negotiating with the plaintiff regarding the amounts owed between the parties, should not be determined to be a waiver of the Commonwealth's sovereign immunity against an affirmative money judgment in federal court, even if the action against the Commonwealth would be considered a compulsory counterclaim. The Court concludes that to the extent that the defendants are claiming against the debtor's estate, the trustee may object to the claim and seek to set-off, up to the amount of the defendants' claim, the sums which the trustee alleges are owed to the estate. The trustee may not, however, seek to obtain an affirmative money judgment against the defendants in federal court without the consent of the Commonwealth of Puerto Rico.

Accordingly, the Court must dismiss this adversary proceeding for lack of jurisdiction because the defendants are immune from suit under the Eleventh Amendment.

ORDER

WHEREFORE IT IS ORDERED that the motion to dismiss (dkt. #31), filed by the defendants, is GRANTED. This adversary proceeding shall be, and hereby is, DISMISSED for lack of jurisdiction. The Clerk shall enter judgment accordingly.

The Clerk shall notify all parties in interest.

The ten-day period for filing a motion to alter or amend this order, pursuant to Fed.R.Bankr.P. 9023, or to file a notice of appeal, pursuant to Fed.R.Bankr.P. 8002(a), shall commence to run upon notice of entry of this order.

SO ORDERED.

San Juan, Puerto Rico this 14th day of October, 1997.

/s/ Gerardo A. Carlo
Gerardo A. Carlo
U.S. Bankruptcy Judge

United States Court of Appeals
For the First Circuit

No. 00-1774

Arecibo Community Health Care, Inc.,
Plaintiff-Appellee,

v.

The Commonwealth of Puerto Rico; Department of Health and Administration of Health Services,
Defendants-Appellants.

Carlos Rodriguez-Quesada,
Trustee-Appellee

United States,
Intervenor-Appellee.

ORDER OF THE EN BANC COURT

Before
BOUDIN, *Chief Judge*, COFFIN and CAMPBELL, *Senior Circuit Judges*, TORRUELLA, SELYA, LYNCH and LIPEZ, *Circuit Judges*.

Entered: January 14, 2002

The panel of judges that rendered the decision in this case having voted to deny the petition for rehearing and the suggestion for rehearing en banc having been carefully considered by the judges of the Court in regular, active service and a majority of said judges not having voted to order that the appeal be heard or reheard by the Court En Banc,

It is ordered that the petition for rehearing and the suggestion for rehearing en banc, be denied.

By the Court:
Richard Cushing Donovan, Clerk

By: /s/ JULIE GREGG
Julie Gregg, Appeals Attorney

[cc: Mr. Dominguez-Perez, Mr. Rivera-Gonzalez, Mr. Stern, Mr. Rodriguez-Quesada, Mr. Goldblatt, Mr. Rodriguez-Isaac, Ms. Casalduc-Rabell, Mr. Sanchez-Ramos, Ms. Lugo-Flores & Mr. Byron.]

Supreme Court, U.S.
FILED
JUN 17 2002

(2)

No. 01-1545

In the Supreme Court of the United States

COMMONWEALTH OF PUERTO RICO, ET AL.,
PETITIONERS

v.

ARECIBO COMMUNITY HEALTH CARE, INC., ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

BRIEF FOR THE FEDERAL RESPONDENTS IN OPPOSITION

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15990

QUESTION PRESENTED

Section 106(b) of the Bankruptcy Code, 11 U.S.C. 106(b), provides that a governmental unit that files a proof of claim in a bankruptcy proceeding waives its immunity from counterclaims that arose out of the same transaction or occurrence. The question presented is whether Section 106(b) violates the Eleventh Amendment to the United States Constitution.

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In the Supreme Court of the United States

No. 01-1545

COMMONWEALTH OF PUERTO RICO, ET AL.,
PETITIONERS

v.

ARECIBO COMMUNITY HEALTH CARE, INC., ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

BRIEF FOR THE FEDERAL RESPONDENTS IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals on rehearing (Pet. App. 1-22) is reported at 270 F.3d 17. The previous opinion of the court of appeals (Pet. App. 23-31) is reported at 244 F.3d 241. The opinion of the district court (Pet. App. 36-50) is reported at 233 B.R. 625.

JURISDICTION

The judgment of the court of appeals was entered on October 29, 2001. A petition for rehearing was denied on January 14, 2002 (Pet. App. 77-78). The petition for a writ of certiorari was filed on April 15, 2002. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

Between 1984 and 1991, governmental units of the Commonwealth of Puerto Rico (petitioners) contracted with Arecibo Community Health Care, Inc. (respondent), to operate the Arecibo Regional Hospital. Pet. App. 3. In 1991, petitioners sued respondent in Puerto Rico court for breach of contract. *Ibid.*

Respondent then filed a voluntary petition for bankruptcy under Chapter 11 of the Bankruptcy Code, 11 U.S.C. 1101 *et seq.* Pet. App. 3. Petitioners filed a proof of claim in the bankruptcy proceeding, asserting that respondent owed them $1.65 million. *Ibid.* After the bankruptcy proceeding was converted to a Chapter 7 liquidation, the Chapter 7 trustee filed a claim against petitioners seeking more than $8.2 million in contract damages allegedly arising from the same contract and operative facts that gave rise to petitioners' claim. *Id.* at 3-4.

Petitioners moved to dismiss the trustee's claim on Eleventh Amendment grounds. Pet. App. 4. The bankruptcy court concluded that the trustee's claims were barred by the Eleventh Amendment. *Ibid.* The district court disagreed, ruling that petitioners had waived their immunity from suit pursuant to 11 U.S.C. 106(b). Pet. App. 5. Section 106(b) provides that "[a] governmental unit that has filed a proof of claim * * * is deemed to have waived sovereign immunity with respect to a claim against such governmental unit that is property of the estate and that arose out of the same transaction or occurrence out of which the claim of such governmental unit arose." 11 U.S.C. 106(b).

The court of appeals initially reversed, holding that Section 106(b) of the Bankruptcy Code violates the Eleventh Amendment. Pet. App. 23-31. The United

States then intervened to defend the constitutionality of Section 106(b), and the United States and respondent sought rehearing of the panel's decision. *Id.* at 6. The court of appeals agreed to rehear the case. *Ibid.*

On rehearing, the court of appeals affirmed the district court's decision upholding the constitutionality of Section 106(b). Pet. App. 1-22. Relying on this Court's decisions, the court of appeals concluded that "a state may waive its immunity through its affirmative conduct in litigation." *Id.* at 12. The court of appeals specifically explained that this Court's decisions in *Gardner* v. *New Jersey*, 329 U.S. 565 (1947), and *College Savings Bank* v. *Florida Prepaid Postsecondary Education Expense Board*, 527 U.S. 666 (1999), make clear that a State waives its Eleventh Amendment immunity when it "voluntarily invokes" federal court jurisdiction. Pet. App. 15. Based on those decisions, the court of appeals concluded that, by filing a proof of claim, petitioners "validly effect[ed] a partial waiver of [their] sovereign immunity." *Ibid.*

The court of appeals then addressed the "scope" of that waiver. Pet. App. 17. The court noted that the "language of § 106(b) itself provides for a waiver of all claims arising out of the same transaction or occurrence as the state's claim." *Id.* at 18. The court further observed that "[w]here a state avails itself of the federal courts to protect a claim," it is "reasonable to consider that action to waive the state's immunity with respect to that claim *in toto*, and, therefore, to construe that waiver to encompass compulsory counterclaims." *Id.* at 18-19. Finally, the court noted that Section 106(b) avoids "the concrete unfairness that a contrary rule would impose on the other bankruptcy creditors." *Id.* at 22.

ARGUMENT

1. Petitioners contend that review is warranted to decide whether Congress may provide that Puerto Rico's filing of a proof of claim in a bankruptcy proceeding waives its immunity from a compulsory counterclaim without violating the Eleventh Amendment. There is a substantial question whether Puerto Rico may properly rely on the Eleventh Amendment in challenging an Act of Congress subjecting it to suit.

This Court has expressly reserved judgment on whether Puerto Rico should be treated as a State for Eleventh Amendment purposes. *Puerto Rico Aqueduct & Sewer Auth.* v. *Metcalf & Eddy, Inc.*, 506 U.S. 139, 141 n.1 (1993). Moreover, even if Puerto Rico may claim an immunity from suit that is equivalent to that of a State when there has been no action by Congress to dispense with Puerto Rico's immunity, it is not clear why Congress would lack authority to effect such a waiver. The Eleventh Amendment refers only to States, not territories, and Congress has broad power over the territories and their forms of government. See U.S. Const. Art. IV, § 3, Cl. 2 ("The Congress shall have Power to dispose of and make all needful Rules and Regulations respecting the Territory * * * belonging to the United States."). In addition, the territories have not entered the Union as States under the constitutional compact that has been understood to confirm the immunity of States, as sovereigns, from suit. Cf. *Blatchford* v. *Native Village of Noatak*, 501 U.S. 775, 780-782 (1991). Because the applicability of the Eleventh Amendment to Puerto Rico is unsettled and could provide an alternative basis for affirming the judgment below, this case is a particularly poor vehicle for resolving the question presented in the petition.

2. Even assuming, arguendo, that Puerto Rico may rely on the Eleventh Amendment, review of the decision below is not warranted. The court of appeals correctly upheld the constitutionality of Section 106(b), and that decision does not conflict with any decision of this Court or any other court of appeals.

Section 106(b) makes clear that filing a proof of claim constitutes a limited waiver of sovereign immunity: By filing a proof of claim, a governmental unit waives its immunity "with respect to a claim against such governmental unit that is property of the estate and that arose out of the same transaction or occurrence out of which the claim of such governmental unit arose." 11 U.S.C. 106(b). As the court of appeals explained (Pet. App. 18-19), the waiver described by Section 106(b) encompasses compulsory counterclaims.

In *Lapides* v. *Board of Regents*, 122 S. Ct. 1640, 1643 (2002), this Court recently reaffirmed that "[a] State remains free to waive its Eleventh Amendment immunity from suit in a federal court." As explained in *Lapides*, a State effects such a waiver by "voluntarily invok[ing] the federal court's jurisdiction." *Id.* at 1644.

Lapides relied on a line of cases beginning "more than a century ago." 122 S. Ct. at 1643. In *Clark* v. *Barnard*, 108 U.S. 436 (1883), the Court held that a State's "voluntary appearance in federal court amounted to a waiver of its Eleventh Amendment immunity." 122 S. Ct. at 1643 (citing *Clark*, 108 U.S. at 447). In *Gunter* v. *Atlantic Coast Line Railroad*, 200 U.S. 273 (1906), the Court held that, in general, "where a state *voluntarily* becomes a party to a cause and submits its rights for judicial determination it will be bound thereby and cannot escape the result of its own voluntary act by invoking the prohibitions of the Eleventh Amendment." *Lapides*, 122 S. Ct. at 1644

(quoting *Gunter*, 200 U.S. at 284) (emphasis added). And in *Gardner* v. *New Jersey*, 329 U.S. 565, 574 (1947), the Court held, "in the context of a bankruptcy claim, that a State 'waives any immunity . . . respecting the adjudication of' a 'claim' that it voluntarily files in federal court." *Lapides*, 122 S. Ct. at 1643-1644 (quoting *Gardner*, 329 U.S. at 574). Those cases establish a "general principle" that a State waives its immunity when it voluntarily invokes federal court jurisdiction. *Id.* at 1644.

By filing a proof of claim in federal bankruptcy court, a State voluntarily and affirmatively invokes the jurisdiction of the federal courts. In light of this Court's precedents, that step amounts to a waiver of Eleventh Amendment immunity. In the absence of a determination by Congress, a court would have to determine the scope of the waiver—whether it extends only to set-off claims, whether it extends to all counterclaims, or whether it extends only to compulsory counterclaims. In Section 106(b), however, Congress resolved any dispute about the scope of that waiver. Under Section 106(b), if the State chooses to file a proof of claim in a bankruptcy proceeding, it, like any other governmental unit, waives any immunity to claims that "arose out of the same transaction or occurrence." 11 U.S.C. 106(b).

Congress's specification of the scope of the State's waiver falls within Congress's broad authority to condition a State's access to a federal program or a federal benefit on a State's waiver of immunity from suit. See *Alden* v. *Maine*, 527 U.S. 706, 755 (1999); *College Savings Bank* v. *Florida Prepaid Postsecondary Education Expense Board*, 527 U.S. 666, 686-687 (1999); *South Dakota* v. *Dole*, 483 U.S. 203, 207 (1987); *Atascadero State Hosp.* v. *Scanlon*, 473 U.S. 234,

246-247 (1985); *Petty* v. *Tennessee-Missouri Bridge Comm'n*, 359 U.S. 275, 278-282 (1959). Just as Congress may condition approval of a federal compact between two States on the States' waiver of immunity from suit, *Petty*, *supra*, and condition a State's receipt of federal funding on such a waiver, *College Savings*, 527 U.S. at 686, Congress may condition access to the benefits of the federal bankruptcy system and the assets of the bankruptcy estate on a State's waiver of its immunity from compulsory counterclaims on behalf of the estate.

Congress's authority to condition access to a federal program or benefit on a waiver of immunity is not without limits: Congress must make the condition sufficiently clear, and the waiver must be related to the purposes of the underlying federal program. *South Dakota* v. *Dole*, 483 U.S. at 207. But those standards are readily satisfied here. Congress clearly specified that the scope of the State's waiver would extend to compulsory counterclaims, and that waiver is closely related to the purposes of a bankruptcy proceeding—to fairly allocate the property of the estate among competing creditors.*

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* In *College Savings*, the Court held that Congress lacks authority to prevent a State from engaging in commercial activity unless it consents to suit. The Court reasoned that "the point of coercion is automatically passed—and the voluntariness of waiver destroyed—when what is attached to the refusal to waive is the exclusion of the State from otherwise lawful activity." 527 U.S. at 687. In that context, waiver and abrogation "are the same side of the same coin." *Id.* at 683. Significantly, however, the Court distinguished conditions on otherwise lawful activity from conditions on participation in a federal program, and reaffirmed that Congress may condition a State's participation in a federal program on a waiver of immunity from suit. *Id.* at 686-687. The Court also reaffirmed that a State waives immunity from suit when it voluntarily invokes federal court jurisdiction. *Id.* at 675-676, 681

The constitutionality of Section 106(b) is also supported by the Court's holding in *Lapides* that waiver based on litigation conduct "rests upon the [Eleventh] Amendment's presumed recognition of the judicial need to avoid inconsistency, anomaly, and unfairness, and not upon a State's actual preference or desire." 122 S. Ct. at 1644.. As the court of appeals explained, the waiver effected by Section 106(b) avoids "the concrete unfairness that a contrary rule would impose on the other bankruptcy creditors, whose pro rata share of the bankruptcy estate would be diminished because the estate cannot obtain the full amount of debt owed to it," even from those making claims against the estate. Pet. App. 22. That consideration is uniquely relevant in bankruptcy, which "is founded upon principles of equity." *Ibid.* (quoting *In re Straight*, 143 F.3d 1387, 1389 (10th Cir.), cert. denied, 525 U.S. 982 (1998)). A fundamental premise of bankruptcy is that all "creditors coming to the bankruptcy court for relief expect they will fare no better or no worse than others of their stature." *Ibid.*

The constitutionality of Section 106(b) is also supported by the Court's holding that when an individual files a proof of claim in bankruptcy court, he loses his Seventh Amendment right to a jury trial on a related preference action brought by the debtor. *Langenkamp* v. *Culp*, 498 U.S. 42, 44-45 (1990) (per curiam). Similarly here, Congress may condition a State's filing of a proof of claim on its waiver of immunity from suit on a compulsory counterclaim.

3. Petitioners contend (Pet. 8) that the principle that a State waives its immunity by invoking federal court

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n.3. Similarly, in *Lapides*, the Court distinguished the kind of waivers repudiated in *College Savings* from waivers through litigation conduct. 122 S. Ct. at 1643.

jurisdiction applies only to defenses to a State's claim and may not extend to an affirmative monetary recovery from the State. In *Lapides*, the Court squarely rejected that contention. 122 S. Ct. at 1644. The Court explained that the principle enunciated in *Gunter*, *Gardner*, and *Clark* "did not turn upon the nature of the relief sought," and "that principle remains sound as applied to suits for money damages." *Ibid.*

Petitioners similarly err in contending (Pet. 7, 9-10, 21) that this Court's decisions in *United States* v. *Shaw*, 309 U.S. 495, 504 (1940); *United States* v. *United States Fidelity & Guaranty Co.*, 309 U.S. 506, 513 (1940), and *Oklahoma Tax Commission* v. *Citizen Band Potawatomi Tribe*, 498 U.S. 505 (1991), establish that a State's waiver through invocation of federal court jurisdiction may not extend to compulsory counterclaims that seek an affirmative recovery from the State. As this Court explained in *Lapides*, "[t]hose cases * * * do not involve the Eleventh Amendment—a specific text with a history that focuses upon the State's sovereignty vis-a-vis the Federal Government." *Lapides*, 122 S. Ct. at 1646. Equally important, those cases all arose in a context in which Congress had not specified that the filing of a claim would waive immunity from compulsory counterclaims. They therefore do not address the authority of Congress to condition the participation of any governmental unit, including a State, in the bankruptcy process on a waiver of immunity from compulsory counterclaims.

4. The decision below is consistent with the Tenth Circuit's decision in *In re Straight*, *supra*. In that case, the Tenth Circuit upheld the constitutionality of Section 106(b), explaining that Congress has the power "to draw the equitable line * * * leav[ing] the choice to the governmental unit. It can eschew bankruptcy

relief and retain its immunity, or it can doff the protective cloak and join the ranks of creditors seeking the benefits from the debtor's estate. That choice is not constitutionally profound, and it is in accord with one of the fundamental principles of bankruptcy." 143 F.3d at 1392. The decisions below and *In re Straight* are the only two cases that have squarely resolved the question of Section 106(b)'s constitutionality. There is therefore no conflict in the circuits on that issue.

Petitioners contend (Pet. 13-14) that the decision below conflicts with the decisions in *In re Friendship Medical Center, Ltd.*, 710 F.2d 1297 (7th Cir. 1983), and *Ohio* v. *Madeline Marie Nursing Homes*, 694 F.2d 449 (6th Cir. 1982). Those cases, however, addressed the scope of waiver under the bankruptcy laws before the enactment of Section 106(b). They therefore have no bearing on the constitutionality of Section 106(b).

As petitioners recognize (Pet. 16 n.8), there is also no conflict between the decision below and the Fourth Circuit's decision in *In re Creative Goldsmiths of Washington, D.C.*, 119 F.3d 1140, 1147-1148 (1997), cert. denied, 523 U.S. 1075 (1998). Because the counterclaims at issue in that case fell outside the scope of Section 106(b), the Fourth Circuit had no occasion to issue a definitive ruling on the constitutionality of that provision. In any event, the dicta in that case do not conflict with the substance of the court of appeals' decision in this case. While the Fourth Circuit questioned Congress's authority to "deem" that certain state conduct constitutes a waiver, it indicated that Section 106(b) "may correctly describe those actions that, as a matter of constitutional law, constitute a state's waiver of the Eleventh Amendment." 119 F.3d at 1147.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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No. 01-1545

IN THE

Supreme Court of the United States

COMMONWEALTH OF PUERTO RICO, ET AL.,
Petitioners,

v.

ARECIBO COMMUNITY HEALTH CARE, INC., ET AL.,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the First Circuit

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QUESTION PRESENTED

Did Congress exceed its constitutional authority in providing, in Section 106(b) of the Bankruptcy Code, that a State that voluntarily chooses to invoke the jurisdiction of a federal court by filing a proof of claim in a bankruptcy case thereby waives its sovereign immunity with respect to compulsory counterclaims?

CORPORATE DISCLOSURE STATEMENT

Respondent Carlos E. Rodríguez-Quesada is the Chapter 7 Trustee appointed in the bankruptcy case filed by Arecibo Community Health Care, Inc. Pursuant to Rule 29.6, Respondent states that Arecibo Community Health Care, Inc. has no parent corporation, and no publicly held company owns 10% or more of Arecibo Community Health Care, Inc.'s stock.

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IN THE

Supreme Court of the United States

No. 01-1545

COMMONWEALTH OF PUERTO RICO, ET AL.,
Petitioners,

v.

ARECIBO COMMUNITY HEALTH CARE, INC., ET AL.,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the First Circuit

BRIEF IN OPPOSITION

Respondent Carlos E. Rodríguez-Quesada, Chapter 7 Trustee of Arecibo Community Health Care, Inc., hereby opposes the petition for writ of certiorari, which seeks review of the First Circuit's opinion on rehearing. This case presents a challenge to the constitutionality of Section 106(b) of the Bankruptcy Code, which provides that when a governmental unit voluntarily invokes the jurisdiction of the federal courts by filing a proof of claim in a bankruptcy case, it waives its sovereign immunity as to compulsory counterclaims. *See* 11 U.S.C. § 106(b).[1] Congress enacted

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[1] Specifically, Section 106(b) provides: "[a] governmental unit that has filed a proof of claim in the case is deemed to have waived sovereign immunity with respect to a claim against such governmental unit that is property of the estate and that arose out of the same transaction or occurrence out of which the claim of such governmental unit arose." *Id.*

this provision in 1978 when it replaced the Bankruptcy Act (which had no express comparable provision) with the Bankruptcy Code.[2] *See* Pub. L. No. 95-598, 92 Stat. 2555 (Nov. 6, 1978).

The conflict in authority asserted in the petition is illusory. Section 106(b) reflects the longstanding principle, recently reaffirmed by a unanimous Court, that a State's voluntary invocation of the jurisdiction of the federal courts waives its sovereign immunity. *See Lapides v. Board of Regents of the Univ. Sys. of Ga.*, 535 U.S. ___, 122 S. Ct. 1640, 1643-44 (2002) (citing *Clark v. Barnard*, 108 U.S. 436, 447 (1883); *Gardner v. New Jersey*, 329 U.S. 565, 574 (1947); and *College Savings Bank v. Florida Prepaid Postsecondary Educ. Expense Bd.*, 527 U.S. 666, 681 n.3 (1999)). The decision below reflects a correct and non-controversial application of that principle.

STATEMENT

1. In 1984, Arecibo Community Health Care, Inc. ("Arecibo") entered into a series of hospital administration contracts with the Puerto Rico Department of Health and the Administration of Health Facilities — both instrumentalities of the Commonwealth of Puerto Rico (collectively, "Puerto Rico"). (Pet. App. 3.) On June 30, 1991, Puerto Rico filed a breach of contract action in the Superior Court of Puerto Rico against Arecibo, arising out of the 1984 contracts. (*Id.*) On July 2, 1991, Arecibo filed a voluntary petition for reorganization under Chapter 11 of the Bankruptcy Code with the United States Bankruptcy Court, District of Puerto Rico. (*Id.*) The case was converted to a Chapter 7 liquidation proceeding on February 14, 1994, and Carlos E.

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[2] As originally enacted, the pertinent language was codified in Section 106(a) in slightly, but not materially, different form. When Congress enacted the Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, 108 Stat. 4106, it recodified that provision as Section 106(b).

Rodríguez-Quesada was appointed the Chapter 7 Trustee. (*Id.*)

Puerto Rico filed a proof of an unsecured claim in the bankruptcy case for $1,650,449.16, for amounts it contended Arecibo owed to it under the 1984 contracts. (*Id.*) Based on the results of an independent audit of the parties' obligations under those contracts, the Trustee contended that not only did the estate not owe any debt to the Commonwealth, but that in fact, the Commonwealth owed the estate substantial sums under those same contracts. Accordingly, the Trustee objected to the Commonwealth's proof of claim and initiated an adversary proceeding in the bankruptcy court against Puerto Rico on December 29, 1995, seeking $ 8,204,494.48 in damages, plus interest, costs, and attorneys' fees. (*Id.* at 3-4.)

2. The bankruptcy court granted the Commonwealth's motion to dismiss the adversary proceeding based on the Eleventh Amendment, holding that Section 106(b) amounts to an abrogation of sovereign immunity, and is therefore unconstitutional in light of this Court's decision in *Seminole Tribe v. Florida*, 517 U.S. 44 (1996). (Pet. App. 71.) The bankruptcy court further held that Puerto Rico did not, by filing a proof of claim, waive its sovereign immunity with respect to Arecibo's mandatory counterclaim. (*Id.* at 75.) In reaching the latter conclusion, the bankruptcy court adopted a narrow reading of this Court's decision in *Gardner v. New Jersey*, 329 U.S. 565 (1947), and held that the waiver of sovereign immunity effected by the filing of a proof of claim extends only to a debtor's counterclaims that would offset, but not exceed, the amount of the State's affirmative claim against the debtor. (*Id.*)

On appeal, the district court rejected the bankruptcy court's conclusion that Section 106(b) constitutes an unconstitutional abrogation of Eleventh Amendment immunity and concluded, instead, that Section 106(b) is a "valid waiver provision" that is "premise[d] . . . upon an

affirmative action by the state to take advantage of, and participate in, the bankruptcy process." (*Id.* at 48-49.) While Puerto Rico's request for rehearing was pending in the district court, this Court decided *College Savings Bank v. Florida Prepaid Postsecondary Education Expense Board*, 527 U.S. 666 (1999), which, while rejecting the doctrine of "constructive waiver" of sovereign immunity, specifically reaffirmed the validity of the waiver in *Gardner* based on voluntary invocation of the jurisdiction of the federal courts. *See id.* at 681 n.3.

On Puerto Rico's interlocutory appeal, the First Circuit initially held that Section 106(b) violated the Eleventh Amendment in light of *College Savings*' rejection of "constructive waiver." Asserting that "this is not 'a case in which the State has affirmatively invoked [a federal court's] jurisdiction,'" (Pet. App. 30 (quoting *College Savings*, 527 U.S. at 675)), the First Circuit concluded that it could not discern "any principled reason" for distinguishing waiver premised on the filing of a proof of claim from "constructive waiver" premised on a State's engaging in otherwise lawful commercial activity. (*Id.* at 30.)

Both Arecibo and the United States (which intervened after the First Circuit's original panel decision to defend the constitutionality of Section 106(b)) sought rehearing, arguing that in invalidating Section 106(b), the First Circuit created a split with every other court of appeals to have considered the question. The panel agreed to rehear the case.

3. On rehearing, the panel reversed itself, upholding the validity of Section 106(b) and concluding that its earlier decision "misinterpreted" this Court's decision in *College Savings*. (Pet. App. 2.) After observing generally that "a state may waive its immunity through its affirmative conduct in litigation" (*id.* at 12), the First Circuit cited to *Gardner*'s statement that "[w]hen the State becomes the actor and files a claim against the fund, it waives any immunity which it otherwise might have had respecting the adjudication of the

claim." (*Id.* at 13 (quoting *Gardner*, 329 U.S. at 574).) The court then noted that because *Gardner* did not involve a counterclaim seeking affirmative recovery from the State, it *could* have been read not to have implicated the Eleventh Amendment at all, *but* that such a narrow reading of *Gardner* was precluded by this Court's decision in *College Savings*, which described *Gardner* as standing "for the unremarkable proposition that a State waives its sovereign immunity by voluntarily invoking the jurisdiction of the federal courts." (*Id.* at 13 & n.11 (quoting *College Savings*, 527 U.S. at 681 n.3).) In addition, the First Circuit further explained that Section 106(b) does not rely upon the sort of "constructive waiver" rejected in *College Savings* because "calling upon a federal court's jurisdiction is fundamentally different, for purposes of the Eleventh Amendment, from merely conducting commercial activity." (*Id.* at 14-15.) Further, the court recognized that "[n]othing in *College Savings* purports to restrict the constitutionally permissible scope of waiver triggered by the state's invocation of the jurisdiction of a federal court," and that "[i]f anything, *College Savings* affirms and reinforces" the permissibility of a waiver that — like that contemplated by Section 106(b) — may extend to affirmative recoveries against the State on mandatory counterclaims in a bankruptcy case. (*Id.* at 17-18.) The First Circuit accordingly joined the Tenth, Fourth, and Second Circuits in upholding the constitutionality of Section 106(b). (*Id.* at 19-20 (citing *In re Straight*, 143 F.3d 1387 (10th Cir. 1998); *In re Creative Goldsmiths*, 119 F.3d 1140 (4th Cir. 1997); and *In re 995 Fifth Avenue Assoc., L.P.*, 963 F.2d 503 (2d Cir. 1995).)

By order dated January 14, 2002, the First Circuit denied the Commonwealth's petition for rehearing *en banc*.

REASONS FOR DENYING THE WRIT OF CERTIORARI

Further review of the First Circuit's decision on rehearing in this case is unwarranted. The courts of appeals unanimously have upheld Section 106(b) of the Bankruptcy Code against the Eleventh Amendment challenge brought here. Thus, no circuit split exists on the question presented. The cases on which Petitioners rely in suggesting the existence of a split predate Section 106(b) and stood only for the proposition that in the absence of legislation providing otherwise, the waiver of sovereign immunity effected by filing a proof of claim was limited to setting off against the asserted claim. The decision below reflects a proper and non-controversial application of settled Eleventh Amendment principles, as articulated in *Gardner* and *College Savings* (and since reaffirmed by *Lapides*).[3]

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[3] In addition, it is far from clear that the question whether Section 106(b) violates the Eleventh Amendment is properly presented in this case. Puerto Rico is not a State. Accordingly, it does not enjoy the same constitutionally-protected immunity that is an "attribute[] of [the] sovereignty" that the "States of the Union" retain under the Constitution. *Principality of Monaco v. Mississippi*, 292 U.S. 313, 323 (1934). Rather, in light of Congress' broad authority to govern the affairs of Puerto Rico, U.S. Const. art. IV, § 3, whatever sovereign immunity Puerto Rico may enjoy exists as a non-constitutional matter of common law, subject to Congress' power to modify or abrogate it. The question presented in this case is premised on Congress' inability to abrogate States' sovereign immunity when acting pursuant to its Article I powers. Because Congress does possess the power to abrogate Puerto Rico's sovereign immunity, the decision below could be affirmed without deciding the question alleged to be presented here. Although the First Circuit has determined that Congress should be presumed to treat Puerto Rico as a State absent clear legislative intent to the contrary, *see Mercado v. Puerto Rico*, 214 F.3d 34, 42-43 (1st Cir. 2000), the Bankruptcy Code's requirement that every "State, Commonwealth, Territory . . . or instrumentality of the United States" waive immunity as a condition of its

I. PETITIONERS' CLAIMS OF A CIRCUIT SPLIT ARE ILLUSORY.

This Court consistently has recognized the "unremarkable proposition," *College Savings*, 527 U.S. at 675, that a State waives its sovereign immunity through affirmative litigation conduct that invokes the jurisdiction of the federal courts, such as filing a proof of claim in a bankruptcy case, *see Gardner*, 329 U.S. at 574, or consenting to removal of a case from state to federal court, *see Lapides*, 122 S. Ct. 1640. In enacting Section 106(b), Congress effectively codified a limited version of this principle, providing that a State waives its sovereign immunity as to compulsory counterclaims by filing a proof of claim in a bankruptcy case. Because the cases to which Petitioners point to illustrate the asserted circuit split did *not* involve Section 106(b), and because every court of appeals decision addressing the constitutionality of § 106(b) has upheld its validity, no circuit split exists on the question presented.

A. This Court's Settled Precedent Makes Clear That Voluntary Invocation of the Jurisdiction of the Federal Courts Effects a Valid Waiver of Sovereign Immunity.

The original Bankruptcy Act of 1898 was silent as to whether the filing of a proof of claim constituted a waiver of sovereign immunity. Against that background, this Court considered in *Gardner* whether the State of New Jersey had waived its sovereign immunity by filing a proof of claim in a bankruptcy case, seeking recovery of back taxes from the debtor's estate. In concluding that it had, this Court stated that "[w]hen the State becomes the actor and files a claim against the fund it waives any immunity which it otherwise

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filing a proof of claim, 11 U.S.C. §§ 101(27), 106(b), makes clear Congress' intent to require Puerto Rico's waiver here.

might have had respecting the adjudication of the claim." 329 U.S. at 574. It is true, as Petitioners point out (Pet. 13), that the debtor in *Gardner* did not file a "counterclaim" seeking affirmative recovery from the State, and so *Gardner* could conceivably have been decided more narrowly — either on the ground that the Eleventh Amendment is not implicated at all, because the debtor's objections to the proof of claim are merely defenses and therefore do not constitute a suit against the State, or on the related ground that the waiver is only effective up to setoff.[4] However, the opinion in *Gardner* expressly states that the filing of a proof of claim effected a *waiver* of sovereign immunity. 329 U.S. at 574.

In recent cases, this Court consistently has repeated and reaffirmed that reading of *Gardner*. In *College Savings*, for example, this Court described *Gardner* as standing for the "unremarkable proposition that a State waives its sovereign immunity by voluntarily invoking the jurisdiction of the federal courts."[5] 527 U.S. at 681 n.3. Likewise, as this

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[4] At common law, the waiver of sovereign immunity effected by the voluntary participation of the United States or an Indian Nation in litigation extended only to setoff and did not permit affirmative recovery from the governmental unit claiming immunity. *See Oklahoma Tax Comm'n v. Citizen Band Potawatomi Indian Tribe*, 498 U.S. 505 (1991); *United States v. United States Fidelity & Guar. Co.*, 309 U.S. 506 (1940). For the reasons explained by this Court in *Lapides* and described below, *see infra* at 13-14, this principle cannot seamlessly be transplanted to the immunity reflected in the Eleventh Amendment, "a specific text with a history that focuses upon the State's sovereignty vis-à-vis the Federal Government," 122 S. Ct. at 1646.

[5] One year earlier, in his concurrence in *Wisconsin Department of Corrections v. Schacht*, 524 U.S. 381 (1998), Justice Kennedy also recognized that in *Gardner*, this Court "found a waiver of the Eleventh Amendment when a State voluntarily appeared in bankruptcy court to file a claim against a common fund." *Id.* at 395 (Kennedy, J., concurring). Presaging this Court's recent holding in *Lapides*, Justice Kennedy drew upon the "voluntary appearance as waiver" principle of *Gardner* to conclude that when a State named as a defendant in state court consents

Court stated in its unanimous decision in *Lapides*, "[t]he Court has long accepted" the "general legal principle" that voluntary invocation of federal court jurisdiction effects a waiver of sovereign immunity. *See* 122 S. Ct. at 1644. Indeed, this Court recognized in *Lapides* that, despite the fact — upon which Petitioners rely (Pet. 9, 13) — that "the cases that stand for [that] principle . . . did not involve suits for money damages against the State . . . the principle enunciated in those cases did not turn upon the nature of the relief sought . . . and remains sound as applied to suits for money damages." 122 S. Ct. at 1643. Thus, the treatment of *Gardner* in *College Savings* and *Lapides* makes clear that the affirmative act of invoking the jurisdiction of the federal courts constitutes a waiver of Eleventh Amendment immunity and permits affirmative recovery against the States.

B. Petitioners' Claimed "Circuit Split" Ignores Congress' Enactment of Section 106(b).

The crux of Petitioners' argument is that the circuits are split as to whether filing a proof of claim in a bankruptcy case constitutes a valid waiver of a State's sovereign immunity as to compulsory counterclaims. There is no such split. The central flaw in Petitioners' argument is that it disregards the effect of Section 106(b). The question presented is not whether, in the absence of any legislative direction, voluntary invocation of federal court authority *ought* to operate as a waiver of sovereign immunity. Pursuant to its power to "establish . . . uniform Laws on the subject of Bankruptcies through the United States," U.S. Const. art. I, § 8, cl. 4, Congress has provided a clear and

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to removal of the case to federal court, its action "may well be regarded as voluntary in the same manner as the appearance[] which gave rise to the waiver[] in . . . *Gardner*." *Id.* at 396.

affirmative answer to that question.[6] The question, then, is whether the Eleventh Amendment restricts Congress' authority to make that choice. The courts of appeals that have considered *that* question have held unanimously that Section 106(b) is a valid exercise of Congress' authority.

The cases Petitioners point to as evidence of a "split" are decisions of the Sixth and Seventh Circuits that arose *prior to* the applicability of Section 106(b).[7] (*See* Pet. 13-14 (discussing *In re Friendship Medical Center, Ltd.*, 710 F.2d 1297 (7th Cir. 1983) and *Ohio v. Madeline Marie Nursing Homes Number One and Number Two*, 694 F.2d 449 (6th Cir. 1982).) Because those cases do not address the constitutionality of Section 106(b) — the question presented here — they cannot possibly create a split of authority that warrants this Court's review.

In *Ohio v. Madeline Marie Nursing Homes Number One and Number Two*, 694 F.2d 449 (6th Cir. 1982), the Sixth Circuit concluded, without addressing the *Gardner* line of authority, that Ohio had not waived sovereign immunity by filing a proof of claim in a bankruptcy proceeding because "the Bankruptcy Act of 1898 does not require waiver of sovereign immunity as a condition to the filing of a claim." *Id.* at 462. Similarly, in *In re Friendship Medical Center,*

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[6] When Congress enacted the Bankruptcy Code and added Section 106, it certainly intended to permit affirmative recovery against a State that filed a proof of claim in a bankruptcy action. According to the House Judiciary Committee, the "governmental unit cannot receive distribution from the estate without subjecting itself to any liability it has to the estate within the confines of the compulsory counterclaim rule. Any other result would be one-sided. The counterclaim by the estate against the governmental unit is without limit." H.R. Rep. No. 95-595 (1977). The Committee went on to say that "[s]ubsection (a) governs affirmative recovery." *Id.*

[7] The 1978 Bankruptcy Code applies to bankruptcy cases filed on or after October 1, 1979. *See* Act of Nov. 6, 1978, Pub. L. No. 95-598, 92 Stat. 2549. *See Brown v. Felsen*, 442 U.S. 127, 129 n.1 (1979).

Ltd., 710 F.2d 1297 (7th Cir. 1983), the Seventh Circuit turned to common law waiver doctrine because no statutory waiver yet existed. In determining whether filing a proof of claim constituted waiver, the Seventh Circuit read *Gardner* to stand for the narrow proposition — not the one articulated by this Court in *College Savings* or *Lapides* — that filing a proof of claim waives sovereign immunity only "to the extent necessary" to adjudicate the State's claim and not to permit affirmative recoveries against the State. *Id.* at 1300.

In enacting Section 106(b), however, Congress chose to codify a broader reading of *Gardner*, which provides that when a State invokes the jurisdiction of the bankruptcy court by filing a proof of claim, it thereby waives its sovereign immunity with respect to counterclaims that arise out of the same transaction or occurrence.[8] Accordingly, contrary to Petitioners' contention (Pet. 12-17), neither of these cases provides any evidence of a split in authority on the question presented here.

C. Every Court of Appeals That Has Considered the Question Has Upheld the Constitutionality of Section 106(b).

Petitioners do not (and cannot) point to any decision of a court of appeals concluding that the particular waiver contemplated in Section 106(b) violates the Eleventh Amendment. Had the original decision of the panel of the First Circuit in this case stood, it would have been the first to so hold and would have created a fresh split of authority. In light of the panel's reversal of its decision, however, the

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[8] It is worth noting that the result the Seventh Circuit reached in *In re Friendship* would obtain under Section 106(b) as well because the claims asserted against the State in *In re Friendship* "were completely unrelated" to the claim upon which the State had filed its proof of claim. *See* 710 F.2d at 1300.

courts of appeals remain unanimous in upholding Section 106(b) against the constitutional challenge presented here.

The Tenth, Fourth, and Second Circuits all have reached the same result as the First Circuit below. In *In re Straight*, 143 F.3d 1387 (10th Cir. 1998), for example, the Tenth Circuit concluded that in providing for the Section 106(b) waiver, Congress "follow[ed] the lead," *id.* at 1392, of this Court's decision in *Gardner* and "codifie[d] the *Gardner* rule but narrow[ed] its applicability" to claims arising out of the "same transaction or occurrence" as the claim asserted by the State, *id.* at 1390. Accordingly, the Tenth Circuit affirmed "the ability of Congress to draw the equitable line across which the state has the option to cross."[9] *Id.* at 1392; *see also In re Creative Goldsmiths of Washington, D.C., Inc.*, 119 F.3d 1140, 1148 (4th Cir. 1997) (holding that "to the extent a defendant's assertions . . . with regard to a state-filed proof of claim in a bankruptcy action, amount to a *compulsory* counterclaim, a state has waived any Eleventh Amendment immunity against that counterclaim in order to avail itself of the federal forum"); *In re 995 Fifth Avenue Assocs., L.P.*, 963 F.2d 503, 508 (2d Cir. 1992) (concluding that former Section 106(a) — materially identical to current Section 106(b) — "largely partakes of the waiver by participation doctrine that received [this Court's] imprimatur in *Gardner*").

II. THE DECISION OF THE FIRST CIRCUIT BELOW IS CORRECT.

The Court of Appeals correctly held that Section 106(b) is a permissible exercise of Congress' authority to condition waiver of sovereign immunity on a State's decision to invoke

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[9] *See also In re Innes*, 184 F.3d 1275, 1280 (10th Cir. 1999) (citing *In re Straight* with approval in analyzing Eleventh Amendment issues under *College Savings*).

the jurisdiction of the federal courts. Petitioners make two main arguments to the contrary: (1) In cases that did not involve statutory provision for waiver or the Eleventh Amendment, the federal government and Indian Nations were permitted to invoke the court's jurisdiction but to retain their sovereign immunity from claims seeking monetary damages beyond setoff (Pet. 21-23); and (2) Section 106(b) is an impermissible "constructive waiver" because filing a proof of claim is not "qualitatively different from the activities dealt with in *College Savings*" (*id.* at 24). Both arguments are foreclosed by an unbroken line of authority — culminating in this Court's recent unanimous decision in *Lapides* — that a State waives its sovereign immunity by voluntarily invoking the jurisdiction of the federal courts.

First, in holding unanimously in *Lapides* that a State's removal of a case from state to federal court waives its Eleventh Amendment immunity, this Court reaffirmed the well-established proposition that "a State's voluntary appearance in federal court amount[s] to a waiver of its Eleventh Amendment immunity." 122 S. Ct. at 1643; *see also Clark v. Barnard*, 108 U.S. 436, 447 (1883) (concluding that "the voluntary appearance of the state in intervening as a claimant of the fund in court" constitutes a waiver of Eleventh Amendment immunity through "voluntary submission to [the court's] jurisdiction"); *Gunter v. Atlantic Coast Line R.R. Co.*, 200 U.S. 273, 284 (1906) (observing that "where a State voluntarily becomes a party to a cause and submits its rights for judicial determination, it . . . cannot escape the result of its own voluntary act by invoking the prohibition of the Eleventh Amendment"). This Court expressly relied on *Gardner* in support of that "general principle" of waiver, *Lapides*, 122 S. Ct. at 1641, reading it to have "held" that "'a State waives any immunity . . . respecting the adjudication of' a 'claim' that it voluntarily files in federal court." *Id.* at 1644 (quoting *Gardner*, 329 U.S. at 574). And, contrary to Petitioners' attempt to minimize what they describe as "a casual reference to

Gardner in *College Savings*" (Pet. 22), *Lapides* treats the discussion of *Gardner* in *College Savings* as evidence of this Court's "long accept[ance of] this statement of the law as [illegible]," 122 S. Ct. at 1644.

Petitioners' reliance on *United States v. United States Fidelity & Guaranty Co.*, 309 U.S. 506 (1940), and *United States v. Shaw*, 309 U.S. 495 (1940), as articulating a controlling and contrary rule that "limits the scope of allowable counterclaims against a sovereign" (Pet. 21) is misplaced. In *Lapides*, this Court rejected Georgia's attempt to make a similar argument, concluding that those cases were inapposite to the specific Eleventh Amendment question presented because "[t]hose cases . . . do not involve the Eleventh Amendment — a specific text with a history that focuses upon the State's sovereignty vis-à-vis the Federal Government." *Id.* at 1646. Moreover, those cases were decided before *Gardner* and, as this Court noted, depended on "special circumstances" that do not apply here, *id.*, including lack of "statutory authority" for waiver and the "unusual governmental organization and peculiar problems" associated with Indian Nations. *United States Fidelity & Guar. Co.*, 309 U.S. at 512, 513. Accordingly, given the inapplicability of these cases and the clear, controlling precedent that voluntary appearance in a federal court constitutes a waiver of Eleventh Amendment immunity, the decision of the First Circuit is correct.

Second, despite Petitioners' contention otherwise, *College Savings* is entirely consistent with the proposition that Congress can condition affirmative access to the federal courts on the kind of waiver of sovereign immunity provided for by Section 106(b). While rejecting the broad theory of "constructive waiver" — under which Congress sought to condition waiver of sovereign immunity on a State's decision to engage in ordinary and otherwise lawful commercial activity — this Court in *College Savings* made a point of distinguishing and ratifying the validity of the waiver it had found in *Gardner*, which arose out of a State's affirmative

litigation conduct. 527 U.S. at 681 n.3 (stating that *Gardner* "stands for the unremarkable proposition that a State waives its sovereign immunity by voluntarily invoking the jurisdiction of the federal courts"). Subsequently, in *Lapides*, this Court explicitly recognized that in *College Savings* it had "distinguished the kind of constructive waivers repudiated there from waivers effected by litigation conduct." *Lapides*, 122 S. Ct. at 1644. Thus, under *College Savings*, Congress may condition waiver on certain actions taken by States, but not others. The activity New Jersey undertook in *Gardner*, invoking the jurisdiction of the federal courts, has long been held to constitute a valid waiver of sovereign immunity. Accordingly, Puerto Rico's decision to file a proof of claim in the Arecibo bankruptcy, in the face of the clear requirement of Section 106(b), is far more like South Dakota's decision to accept federal highway funds, *see South Dakota v. Dole*, 483 U.S. 203 (1987) (cited with approval in *College Savings*, 527 U.S. at 686-87), than it is like Florida's decision to advertise its college tuition savings program, *see College Savings*, 527 U.S. at 691.[10]

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[10] The fact that this Court has held that the act of filing a proof of claim in a bankruptcy proceeding constitutes a valid waiver of other constitutional rights provides further support for the First Circuit's decision in this case. *See Langenkamp v. Culp*, 498 U.S. 42, 44-45 (1990) (per curiam) (holding that a creditor's filing of a proof of claim constitutes a waiver of the Seventh Amendment right to jury trial of related preference actions brought by a debtor because that act subjects the creditor to "the bankruptcy court's equitable power" to effect "the restructuring of the debtor-creditor relationship"); *see also In re PNP Holdings Corp.*, 99 F.3d 910, 911 (9th Cir. 1996) (per curiam) (holding that the filing of a proof of claim waives an individual's due process right not to be haled into a court with which he or she otherwise would lack minimum contacts); *SEC v. Infinity Group Co.*, 27 F. Supp. 2d 559, 562 (E.D. Pa. 1998) (same). Indeed, to treat sovereign immunity differently from other constitutional rights in this context would be inconsistent with the established proposition that "there is no . . . hierarchy among[] constitutional rights." *Caplin & Drysdale, Chtd. v. United States*, 491 U.S. 617, 628 (1989).

Although Petitioners criticize the First Circuit for allegedly failing to articulate the rationale for this distinction (Pet. 24), as this Court recently explained, it "makes sense because an interpretation of the Eleventh Amendment that finds waiver in the litigation context rests upon the Amendment's presumed recognition of the judicial need to avoid inconsistency, anomaly, and unfairness, and not upon a State's actual preference or desire." *Lapides*, 122 S. Ct. at 1644. Indeed, "[i]t would seem anomalous or inconsistent for a State both (1) to invoke federal jurisdiction, thereby contending that the 'Judicial power of the United States' extends to the case at hand, and (2) to claim Eleventh Amendment immunity, thereby denying that the 'Judicial power of the United States' extends to the case at hand." *Id.* at 1641.

This is particularly true in the bankruptcy context where cases are "in the nature of an interpleader," *Clark*, 108 U.S. at 448, and the estate's claims against a creditor are "part and parcel of the [claims] allowance process," *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33, 58 (1989). A core principle of bankruptcy is that a creditor's claims against a debtor "cannot be separated" from the debtor's related claims against its creditor because, like two sides of the same coin, they are "not distinct suits . . . but parts of one suit in bankruptcy." *Wiswall v. Campbell*, 93 U.S. 347, 348 (1876); *see also Katchen v. Landy*, 382 U.S. 323, 332 n.9 (1966) (holding that "determination of objections to claims, whether or not affirmative relief is decreed, does not constitute adjudication of a suit by the trustee"). Under such circumstances, if "a state desires to participate in the assets of a bankrupt, she must submit to appropriate requirements by the controlling power; otherwise, orderly and expeditious proceedings would be impossible and a fundamental purpose of [bankruptcy law] would be frustrated." *New York v. Irving Trust Co.*, 288 U.S. 329, 333 (1933).

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted,

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COMMONWEALTH OF PUERTO RICO, *et al.*,

Petitioners,

v.

ARECIBO COMMUNITY HEALTH CARE, INC., *et al.*,

Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The First Circuit

BRIEF OF AMICI CURIAE STATES OF CALIFORNIA, ALABAMA, ALASKA, DELAWARE, FLORIDA, IDAHO, KANSAS, LOUISIANA, MASSACHUSETTS, MICHIGAN, MINNESOTA, MISSISSIPPI, MISSOURI, MONTANA, NEBRASKA, NEW HAMPSHIRE, NEW YORK, NORTH CAROLINA, OHIO, OKLAHOMA, OREGON, PENNSYLVANIA, SOUTH DAKOTA, TENNESSEE, TEXAS, UTAH, VERMONT, WEST VIRGINIA, WYOMING AND TERRITORY OF THE VIRGIN ISLANDS IN SUPPORT OF COMMONWEALTH OF PUERTO RICO

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U.S. Const., Amend. XI 1, 2, 4, 6

INTEREST OF AMICI CURIAE

Amici curiae file this brief in support of Puerto Rico's petition for certiorari to review the decision of the First Circuit in *Arecibo Community Health Care, Inc. v. Commonwealth of Puerto Rico*, 270 F.3d 17 (1st Cir. 2001). In that decision, the court of appeals ruled that the Commonwealth necessarily waived its immunity to a debtor's counter-suit for positive relief by filing a claim against the debtor's bankruptcy estate. The decision has obvious implications for all of Amici States who must daily avail themselves of the processes of the bankruptcy courts in order to safeguard the interest of taxpayers in the assets of bankruptcy estates.

Amici contend that the sovereign immunity guaranteed them by the Eleventh Amendment is no less protective against counter-suits than is the sovereign immunity enjoyed by Indian tribes and the United States. The only legal consequence of filing a claim in bankruptcy court should be that the claim is allowed or disallowed. The only financial consequence to a State of filing a claim in bankruptcy court should be that the claim is paid or not paid in whole or in part. Amici respectfully submit that Puerto Rico's petition for certiorari should be granted to make that clear.

SUMMARY OF ARGUMENT

On three occasions, this Court has recognized that, by merely prosecuting a claim to protect the assets of its constituency, a sovereign does not thereby waive its immunity to counter-suits. *United States v. U.S. Fidelity Co.*, 309 U.S. 506, 512-513 (1940); *United States v. Shaw*,

309 U.S. 495 (1940); and *Oklahoma Tax Comm'n v. Potawatomi Tribe*, 498 U.S. 505 (1991). None of those cases involved assertions of sovereign immunity by States or by the Commonwealth of Puerto Rico, but Amici contend that the principles in those cases are applicable with equal vigor to bar counter-suits for positive relief prompted by the filing of claims in bankruptcy court.

The First Circuit did not consider the effect of *U.S. Fidelity Co., Shaw,* or *Potawatomi Tribe* on Puerto Rico's claim of immunity from counter-suit in bankruptcy proceedings. This Court should, therefore, grant Puerto Rico's petition to confirm that the sovereign immunity to suit embodied in the Eleventh Amendment is not different from that enjoyed by the United States and Indian tribes, such that neither a State nor Puerto Rico surrenders its immunity to counter-suit for positive relief merely by filing a claim in bankruptcy court. Indeed, the Court should grant the petition because dicta in the Court's recent decision in *Lapides v. Board of Regents of Univ. System of Ga.*, 535 U.S. ___, 122 S.Ct. 1640, 2002 WL 970637 (May 13, 2002), could be read to suggest precisely to the contrary.

ARGUMENT

I

THE PETITION SHOULD BE GRANTED TO SETTLE ANY DOUBT THAT THE MERE FILING OF A CLAIM IN BANKRUPTCY FOR THE PROTECTION OF TAXPAYER ASSETS DOES NOT CONSTITUTE A WAIVER OF ELEVENTH AMENDMENT IMMUNITY TO COUNTER-SUIT FOR POSITIVE RELIEF

It has long been recognized that, by virtue of their inherent sovereignty, neither the United States nor an Indian Tribe waives immunity to suit merely by prosecuting a claim in court for the protection of taxpayer or tribal assets. In *United States v. U.S. Fidelity Co.*, 309 U.S. 506, 512-513 (1940), the Court held that the United States' claim in bankruptcy on behalf of an Indian tribe does not waive the immunity of either the United States or the tribe from counter-suit for a positive recovery. On the same day, the Court held in *United States v. Shaw*, 309 U.S. 495, 501-504 (1940), that the United States' claim in a probate case does not waive immunity from counter-suit. More recently, in *Oklahoma Tax Comm'n v. Potawatomi Tribe*, 498 U.S. 505, 509-510 (1991), the Court held that the filing by an Indian tribe of a civil action to enjoin assessment and collection of state taxes does not waive the tribe's immunity from a counter-suit in that action.

The First Circuit in the proceedings below, however, has ruled that the Commonwealth of Puerto Rico waived its immunity to a counter-suit for positive relief by filing a claim in bankruptcy proceedings for the protection of

taxpayer monies.[1] The court reasoned that the Commonwealth's choice to avail itself of the aid of the bankruptcy court amounted to an affirmative waiver of immunity, distinguishable from the "constructive waiver" rejected in *College Savings Bank v. Florida Prepaid Postsecondary Ed. Expense Bd.*, 527 U.S. 666 (1999). The court's analysis omits any reference whatsoever to this Court's seminal decision in *United States v. U.S. Fidelity Co.* and the principles articulated therein. In particular, the circuit court failed to appreciate the distinction between a waiver of immunity for purposes of "objection" to a State's claim, *see Gardner v. New Jersey*, 329 U.S. 565, 572-575 (1947), and a counter-suit by the debtor for positive relief. The analysis in *U.S. Fidelity Co.*, would not bar a set-off of a sovereign's claim by amounts found to be owed to the debtor in bankruptcy; but *U.S. Fidelity* does bar a counter-suit for positive relief.

The First Circuit's reasoning notwithstanding, Amici respectfully submit that the filing of a claim in bankruptcy cannot reasonably be considered an affirmative, unequivocal waiver of immunity to counter-suit. When a creditor files bankruptcy, the States – like the United States and Indian tribes – have no means to safeguard taxpayer interest in the bankruptcy estate except to avail themselves of the processes of the bankruptcy court. It follows, then, that States – no less than the United States and Indian tribes – must have an opportunity to participate in those processes without being deemed thereby to have waived their Eleventh Amendment immunity to counter-suits for

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[1] The circuit court acknowledged that Puerto Rico enjoys immunity from suit under the Eleventh Amendment. *Arecibo Community Health Care, Inc.*, 270 F.3d at 21, fn. 3.

positive relief by the debtor. As this Court noted: "The sovereignty possessing immunity should not be compelled to defend against cross-actions . . . *in courts not of its choice*, merely because its debtor was unavailable except outside the jurisdiction of the sovereign's consent." *United States v. U.S. Fidelity Co., supra*, 309 U.S. 506, 513 (emphasis added). Amici therefor urge the Court to grant Puerto Rico's petition to settle this important question of federal law.

While it may be conceded that neither *U.S. Fidelity Co., Shaw* nor *Potawatomi Tribe* involved a claim of *state* sovereign immunity, nevertheless, under any rational analysis, the rule articulated by the Court in *U.S. Fidelity Co.* should be just as applicable to the inherent sovereignty of the several States as it is to the inherent sovereignty enjoyed by the United States or by Indian tribes.[2] This Court observed, in *Blatchford v. Native Village of Noatak*, 501 U.S. 775 (1991), that:

> Despite the narrowness of its terms, since *Hans v. Louisiana*, 134 U.S. 1 (1890), we have understood the Eleventh Amendment to stand not so much for what it says, but for the presupposition of our constitutional structure which it confirms: that the States entered the federal system with their sovereignty intact; that the judicial authority in Article III is limited by this sovereignty, [citations]; and that a State will therefore not be

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[2] Indeed, the immunity enjoyed by Indian tribes is that of a "dependent" sovereign. *See Three Affiliated Tribes v. Wold Engineering*, 476 U.S. 877, 890 (1986) ("Of course, because of the peculiar 'quasi-sovereign' status of the Indian tribes, the Tribe's immunity is not congruent with that which the Federal Government, or the States, enjoy.")

> subject to suit in federal court unless it has consented to suit, either expressly or in the "plan of the convention."

Id. at 779. More recently, in *Alden v. Maine*, 527 U.S. 706 (1999), the Court acknowledged that the phrase "Eleventh Amendment immunity" is:

> convenient shorthand but something of a misnomer, for the sovereign immunity of the States neither derives from, nor is limited by, the terms of the Eleventh Amendment. Rather, as the Constitution's structure, its history, and the authoritative interpretations by this Court make clear, the States' immunity from suit is a fundamental aspect of the sovereignty which the States enjoyed before the ratification of the Constitution, and which they retain today (either literally or by virtue of their admission into the Union upon an equal footing with the other States) except as altered by the plan of the Convention or certain constitutional Amendments.

527 U.S. at 712-713; *accord*, *Federal Maritime Comm'n v. South Carolina Ports Authority*, 535 U.S. ___, ___ (slip opn., pp. 6-7, 14, 20) (May 28, 2002). This Court has "recognized a correlation between sovereign immunity principles applicable to the States and the Federal Government." *California v. Deep Sea Research, Inc.*, 523 U.S. 491, 506-507 (1998); *see also, College Savings Bank v. Florida Prepaid Postsecondary Ed. Expense Bd.*, 527 U.S. at 682 (federal sovereign immunity is "obviously the closest analogy" to state sovereign immunity). Such a near identity of bases for sovereign immunity reasonably warrants extension of the *U.S. Fidelity Co.* rule to encompass Eleventh Amendment immunity.

II

REVIEW SHOULD BE GRANTED TO CLARIFY THAT DICTA IN THIS COURT'S RECENT DECISION IN *LAPIDES v. BOARD OF REGENTS* SHOULD NOT BE READ TO DENY STATES THE FULL IMMUNITY FROM COUNTER-SUIT THAT IS ENJOYED BY THE UNITED STATES AND INDIAN TRIBES PURSUANT TO *U.S. FIDELITY CO.*, *SHAW*, AND *POTAWATOMI TRIBE*

In *Lapides v. Board of Regents of Univ. System of Ga.*, 535 U.S. ___, 122 S.Ct. 1640, 2002 WL 970637 (May 13, 2002), the Court held that a State's act of removing a lawsuit from state court to federal court waives the State's Eleventh Amendment sovereign immunity. In the course of its analysis, the Court had occasion to address Georgia's reliance on *U.S. Fidelity Co.*, *Shaw*, and *Potawatomi Tribe*:

> The State makes several other arguments, none of which we find convincing. It points to cases in which this Court has permitted *the United States* to enter into a case voluntarily without giving up immunity or to assert immunity despite a previous effort to waive. See *United States v. United States Fidelity & Guaranty Co.*, 309 U.S. 506 (1940); *United States v. Shaw*, 309 U.S. 495 (1940); see also *Oklahoma Tax Comm'n v. Citizen Band Potawatomi Tribe of Okla.*, 498 U.S. 505 (1991). Those cases, however, do not involve the Eleventh Amendment – a specific text with a history that focuses upon the State's sovereignty vis-a-vis the Federal Government. And each case involves special circumstances not at issue here, for example, an effort by a sovereign (i.e., the United States) to seek the protection of its own courts (i.e., the federal courts), or an effort to protect an Indian tribe.

> Slip opn., p. 9; 2002 WL 970637, p. 5 (emphasis in original.)

The present case does indeed involve "an effort by a sovereign" (*i.e.*, the Commonwealth of Puerto Rico) "to seek the protection of its own courts" (*i.e.*, the commonwealth courts). Puerto Rico filed its suit against the debtor in the Superior Court of Puerto Rico, 270 F.3d at 21, but was thwarted in that effort by the debtor's initiation of bankruptcy proceedings. Endeavoring to protect the interests of its citizens in the consequent bankruptcy estate, the Commonwealth took the reasonable and proper action of filing its claim in the bankruptcy court. Puerto Rico thus "invoked" the jurisdiction of the federal court for one purpose, and for one purpose only – to allow or disallow that claim.

Unlike the State of Georgia in *Lapides*, Puerto Rico did not invoke the jurisdiction of a federal court to hear its defenses to someone else's suit, for the suit against Puerto Rico had not even been brought when Puerto Rico filed its claim. By removing a pending state-court suit against it to federal court, Georgia was effectively a voluntary defendant. The Court thus quite correctly observed that neither *U.S. Fidelity, Shaw*, nor *Potawatomi* was germane to Georgia's situation. None of those cases purports to preserve sovereign immunity where the sovereign effectively invites adjudication of the dispute in a tribunal outside the jurisdiction of the sovereign's consent.

However, the articulated bases on which this Court distinguished *U.S. Fidelity, Shaw,* and *Potawatomi Tribe*, quoted above, could be read to suggest that the principles of sovereign immunity developed in those cases have no application to Eleventh Amendment claims by States (or

Puerto Rico) to counter-suits. But as discussed above, the Court's reasoning in those three earlier cases should apply with equal vigor to encompass state assertions of sovereign immunity to counter-suits in bankruptcy. The Court should, therefore, grant Puerto Rico's petition to clarify the meaning of its dicta in *Lapides*.

CONCLUSION

Under any reasonable analysis, the rule recognized in *United States v. U.S. Fidelity Co.*, *Shaw*, and *Potawatomi Tribe* – that a sovereign's claim in a bankruptcy case does not waive the sovereign's immunity from counter-suit for a positive recovery – should apply as much to Eleventh Amendment immunity as it does to the sovereign immunity of an Indian tribe or the United States. The decision of the First Circuit below is utterly inconsistent with that rule.

For these reasons articulated herein, the Court should grant Puerto Rico's petition for a writ of certiorari.

Respectfully submitted,

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In The
Supreme Court of the United States

COMMONWEALTH OF PUERTO RICO, *et al.*,

Petitioners,

v.

ARECIBO COMMUNITY HEALTH CARE, INC., *et al.*,

Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The First Circuit

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Reply Brief Of Petitioners

In its Petition for Certiorari, the Commonwealth of Puerto Rico identified a clear conflict among the circuits as to the fundamental constitutional question of the applicable standard for determining the scope of waiver that arises upon the filing of suit by a state in federal bankruptcy court.[1] If the waiver is narrow – as two courts of appeal have found and the court below initially held – it would almost certainly follow that the "deemed waiver" language in Section 106(b) of the Bankruptcy Code is unconstitutional under the views announced in *College Savings Bank v. Florida Prepaid Postsecondary Education Expense Board*, 527 U.S. 666 (1999). As the Petition further shows, this conflict, and its effect on the validity of Section 106(b), is of critical concern to the states. They need to know, clearly and unambiguously, whether they become the equivalent of a private litigant simply by filing a claim, so that they can gauge the risks they face if they choose to participate in a bankruptcy to protect the rights of their citizens.

In their Opposition, Respondents suggest that there is no conflict between the circuits in that none have yet specifically held that *College Savings* renders Section 106(b) unconstitutional. They further assert that the

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[1] The First Circuit acknowledged that Puerto Rico should be treated like a state for purposes of applying the Eleventh Amendment. App. p. 4, fn. 3. While there are some differences between the treatment of Puerto Rico and the 50 states, the court below did not rely on those differences in deciding this case. The Opposition notes, but does not strongly rely on, this issue as a reason for denial of certiorari. The Commonwealth urges the Court to grant certiorari because the question it presents is of such significance that it deserves immediate attention – as attested to by the 29 states and the Territory of the Virgin Islands that signed the amicus brief, asking the Court to hear the matter now.

decision in *Lapides v. Board of Regents of Univ. System of Ga.*, 535 U.S. ___, 122 S.Ct. 1640, 2002 WL 970637 (May 13, 2002), supports the merit of the First Circuit's position. Their first argument is a red herring, which ignores the split actually identified by the Commonwealth; and their second argument underscores the importance of taking this case in order to clarify the dicta contained in the *Lapides* opinion.

I. The Conflict Among the Courts of Appeal is Direct and Genuine, and Must be Resolved in Order to Determine Whether Section 106(b) of the Bankruptcy Code is Constitutional

As shown in the Petition, there is a clear circuit split regarding whether, as a constitutional matter, a state broadly waives its sovereign immunity and becomes the equivalent of a private litigant when it files suit in bankruptcy court, so as to allow affirmative monetary awards to be entered against it. The circuit courts that have upheld Section 106(b) have relied primarily on their answer to that constitutional question. Two other courts of appeal have answered that fundamental question differently and their rationale would appear to doom Section 106(b). Only this Court can resolve the constitutional conflict and provide the framework for resolving the validity of the statute.

This Court held in *United States v. U.S. Fidelity & Guaranty Co.*, 309 U.S. 506, 60 S.Ct. 653, 84 L.Ed. 894 (1940), *United States v. Shaw*, 309 U.S. 495, 60 S.Ct. 659, 84 L.Ed. 888 (1940), and *Oklahoma Tax Commission v. Citizen Band Potawatomi Indian Tribe of Oklahoma*, 498 U.S. 505, 111 S.Ct. 905, 112 L.Ed.2d 1112 (1991), discussed at pp. 9-12 of the Petition, that in cases involving the United States and Indian tribes, filing a claim in either federal or state court is not a general waiver of immunity

and does not allow relief to be entered that exceeds in amount or that differs in kind from that sought by the entity that filed suit. The lower federal courts, as shown at pp. 11-12 of the Petition, have readily applied the same standard to states in nonbankruptcy cases.[2] In bankruptcy, however, as shown in the Petition, pp.12-17, courts have asserted differing views.

The Sixth and Seventh Circuits, operating under the constitutional standard that applied before statutory abrogation language was included in the Bankruptcy Code, held that the same standard applied to states as to other governmental entities. Under that view, Section 106(b) plainly is a substantial expansion of the common law in that it allows for affirmative relief and, after this Court's decision in *Seminole Tribe of Florida v. Florida*, 517 U.S. 44 (1996), and *College Savings*, appears to be presumptively invalid.

On the other hand, the First Circuit, and other circuit courts taking similar positions since the statutory changes, read this Court's decision in *Gardner v. New Jersey*, 329 U.S. 565 (1947), as finding a broad constitutional waiver by a state that files a claim in bankruptcy

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[2] This is so because no action is being taken *against* a state when it files a federal suit or a proof of claim. Nor, as stated in *Gardner v. New Jersey*, 329 U.S. 565 (1947), has any action been taken against the state merely because a defendant defends itself by denying the state's allegations. Since recoupment is also viewed as a defense, there is no more need to show consent by the government to assert those types of claims than for any other defense. However, since such claims may be heard precisely because they are *defenses*, they have no basis except to defeat the government's claim. If additional recovery, in the nature of affirmative or different relief, is to be allowed after the government's claim is denied, this must be based upon some independent basis of jurisdiction or by a showing of actual consent by the state to litigation of the additional relief. See cases cited in Petition, pp. 11-12, fn. 4 and 5.

court.[3] Having concluded that the common law already finds a general waiver of immunity, such that states become the functional equivalent of private litigants, they assume the constitutionality of Section 106(b) to be a given. Indeed, under their view, Section 106(b) does not approach the limits of what Congress could have stated that states have acceded to upon the filing of a proof of claim. Thus, Section 106(b) is either wholly unnecessary or could even be seen as *narrowing* the constitutional standard. *In re Straight*, 143 F.3d 1387, 1390 (10th Cir.), *cert. denied*, 525 U.S. 982 (1998).

In short, there are two diametrically opposed views of the background constitutional rule regarding waivers by states of their immunity. In the Sixth and Seventh Circuits, some additional power must be found in order to validate Section 106(b). If Congress may require States to agree to be sued for affirmative relief in order to engage in the lawful activity of filing claims in a bankruptcy case, these Circuits would require some basis be shown beyond the constitutional implications arising from the filing of a suit. The First Circuit and its adherents, on the other hand, see no need to identify any further source of Congressional power and would find no immunity-related limits on what Congress may do. No other authority is needed because the filing itself evidences consent by the state to being treated as a private litigant and Section 106(b) is obviously valid. The conflict between those two views is real and critical and requires resolution by this Court now.[4]

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[3] The First Circuit read *Gardner* expansively and added that it took *College Savings* as expanding upon even that holding. App. p. 13.

[4] Prior to *Seminole* and *College Savings*, and especially after *Pennsylvania v. Union Gas*, 491 U.S. 1 (1989), the constitutional issue may have seemed irrelevant. If Congress could abrogate state immunity as broadly as it chose, so long as it did so clearly and unmistakably, the only issue was one of statutory construction. After, this Court held in

(Continued on following page)

II. If the Conflict is Not Resolved, States in at Least Six Circuits Will Risk Entry of Affirmative Relief if They Participate in a Federal Court Proceeding

If, as the First Circuit opinion suggests, there is a broad waiver of immunity from filing a claim, then Congress may obviously allow mandatory counterclaims to be filed against the state even if this results in the state being exposed to vastly larger claims than those that it filed. Indeed, if the filing of a claim inherently strips the state of *all* immunity, there is no obvious limit to the conditions that can be placed upon the state once it enters federal court. *College Savings* rejected the notion that Congress could require a state to waive its immunity in order to engage in lawful activity. But, if filing a claim inherently waives *all* immunity, then Congress need demand no further waiver in order to allow affirmative relief against states. The only condition would be that Congress must state its intention with the necessary clarity.

This broad waiver rule forces states into a "Hobson's choice" – file a claim and be subject to unlimited liability on even unrelated matters – or forego entirely the right to seek compensation for their citizens. Moreover, they cannot avoid the problem by limiting themselves to proceeding only

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Hoffman v. Conn. Dept. of Income Maint., 492 U.S. 96 (1989), and *Nordic Village v. U.S.*, 503 U.S. 30 (1992), that Congress had failed to use the requisite clarity in then-Section 106(c), the statute was amended in 1994. After *Seminole*, the circuit courts agreed that the abrogation language in new Section 106(a) was unconstitutional, but debated whether the "deemed" waiver in Sections 106(b) and (c) was equivalent to abrogation. After *College Savings* held that such language was the "same side of the same coin" as abrogation, 527 U.S. at 683, the courts have returned to the earlier debate over whether there is a separate constitutionally-based waiver that arises upon the filing of a claim.

in state courts. If a bankruptcy is filed, the state may collect money it is owed for taxes, for child support, for consumer protection, and the like, only by entering the federal proceeding. The same requirements apply to the United States government and Indian tribes, but they do not face the threat of unlimited, affirmative relief on counterclaims.[5] Moreover, while thus far circuit courts have adopted this broad waiver analysis only in the bankruptcy context, it is not based on anything unique to bankruptcy. If this Court upholds the broad standard sought by Respondents, then parties are likely to argue that the same result applies outside of bankruptcy. Since some actions, like those under CERCLA, can only be brought in federal court, this principle is likely to result in a far wider impact on states than merely in bankruptcy.

The Commonwealth respectfully suggests that issues dealing with state immunity, particularly in bankruptcy, cry out for this Court's attention without undue delay. In *Puerto Rico Aqueduct and Sewer Authority v. Metcalf & Eddy, Inc.*, 506 U.S. 139 (1993), this Court concluded that the importance of sovereign immunity issues to the Commonwealth warranted the grant of a broad right of interlocutory appeal. Similar considerations suggest that this Court should not leave the law in continued confusion and the states and lower courts without guidance as to the potential liability the states face when they enter federal court.

Indeed, while the Court has addressed ramifications of its pivotal decision in *Seminole* in many areas, it has not yet taken a case applying those principles to bankruptcy

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[5] This unlimited liability contrasts dramatically with Spending Clause cases which require some "nexus" between the benefit proffered and the demanded waiver of immunity, and where it is recognized that the *quid pro quo* might be so burdensome as to become unlawfully coercive. *College Savings*, 527 U.S. at 687. No such limit exists here.

matters. As a result, despite the recognition in *Seminole* by both the majority and the dissent, that its holding would apply to bankruptcy (517 U.S. at 1132, fn. 16, and 517 U.S. at 1134, fn. 1), some lower courts have remained unconvinced that its holding applies at all in the bankruptcy arena. See, e.g., *In re Hood,* 262 B.R. 412 (6th Cir. BAP 2001). Granting certiorari would further allow the Court to affirm that bankruptcy, like other Article I powers, is governed by *Seminole*.

III. *Lapides* Heightens the Need For the Court to Review this Case

In *Lapides v. Board of Regents of Univ. System of Ga.*, 535 U.S. ___, 122 S.Ct. 1640, 2002 WL 970637 (May 13, 2002), the Court held that the state's agreement to the removal of a lawsuit to federal court waived its Eleventh Amendment immunity. That suit, though, involved only the issue of whether the state had consented to the federal court hearing the precise claims that had been filed against it in state court. The case did not involve the scope of a state's waiver of immunity from new counterclaims filed by a defendant. In its brief in *Lapides*, however, the state of Georgia briefly cited the *Shaw, U.S. Fidelity & Guaranty,* and *Potawatomi* line of cases to illustrate the stringent nature of the review this Court has used in determining if a particular action of a sovereign shows consent to suit. In distinguishing those cases, this Court described the state's brief as pointing

> to cases in which this Court has permitted *the United States* to enter into a case voluntarily without giving up immunity or to assert immunity despite a previous effort to waive.... Those cases, however, do not involve the Eleventh Amendment – a specific text with a history that focuses upon the State's sovereignty vis-a-vis the Federal

> Government. And each case involves special circumstances not at issue here, for example, an effort by a sovereign (i.e., the United States) to seek the protection of its own courts (i.e., the federal courts), or an effort to protect an Indian tribe. Slip op. at 9; 2002 WL 970637, p. 5 (emphasis in original).

Respondents read that language to suggest that (1) there is a difference between the true "sovereign immunity" of the United States in its own courts and that of the states in another sovereign's courts, and (2) Indian tribes are to be protected by granting them greater immunity than that held by the states. Br. in Opp. 13. As such, they argue that the cases relied upon by the Commonwealth cannot be used to show that the common-law standard set out therein for the United States and Indian tribes is applicable to the states.

Both of those propositions, however, would mark a radical departure from this Court's existing treatment of sovereign immunity. To read *Lapides* as suggested would require one to assume that this Court had, *sub silentio*, overruled decades of case law that treated the immunities of various governmental entities as largely interchangeable. In *College Savings, supra*, 527 U.S. at 682, for instance, this Court stated that "in the context of federal sovereign immunity – obviously the closest analogy to the present case – it is well established that waivers are not implied. . . . We see no reason why the rule should be different with respect to state sovereign immunity." Similarly, in *California v. Deep Sea Research, Inc.*, 523 U.S. 491, 506-07 (1998), this Court, in making its decision to *deny* immunity to the state noted that "[i]n considering whether the Eleventh Amendment applies . . . , this Court's decisions in cases involving the sovereign immunity of the Federal Government . . . provide guidance, for this Court has recognized a correlation between sovereign immunity principles applicable to States and the Federal Government." 523 U.S. at 506-07.

This Court has relied in many other decisions on similarities between the treatment of various sovereign immunities in deciding how particular cases should be decided and has cited cases involving the different immunities interchangeably. A limited sample would include *Tindal v. Wesley*, 167 U.S. 204, 213 (1897) ("it cannot be doubted that the question whether a . . . suit is against the State . . . must depend upon the same principles that determine whether a . . . suit is against the United States"); *Malone v. Baldwin*, 369 U.S. 643, 646 n.6 (1962) (discusses *United States v. Lee*, 106 U.S. 196 (1882) and cites both state and federal cases on state immunity issue); *Monaco v. Mississippi*, 292 U.S. 313, 320-21 (1934) (relies on fact that United States retained sovereign immunity, despite wording of Article III, as reason to find that states also retain immunity from suit); *Pennhurst State School & Hospital v. Halderman*, 465 U.S. 89 (1984) (applied *Dugan v. Rank*, 372 U.S. 609, 620 (1963), a federal case, to define when suit is "against" the state; dissent relied extensively on *federal* immunity cases to argue that *state* officers could be sued); and *Blatchford v. Native Village of Noatak and Circle Village*, 501 U.S. 775 (1991) (related rights of tribes to rights of states).

Under that well-established line of cases, the Commonwealth is entitled to the same degree of protection as the United States – and, as *Blatchford* makes clear – surely as much as Indian tribes. If so, then it is critically important that this Court clarify that the distinctions drawn in the *Lapides* case were not meant to overrule this longstanding correlation. If, on the other hand, this Court actually intended to establish a new rule that sets the various forms of immunity on a sliding scale, with states' Eleventh Amendment immunity at the bottom of that scale, then it is vitally important for the states to know this. The legislative branch is required to speak with the

utmost clarity; it is equally important for this Court to clearly define both the limits of the state's immunity and the rationale for allowing any infringement on that immunity.[6]

Conclusion

Accordingly, for the reasons stated above, the Commonwealth respectfully urges this Court to grant its petition for certiorari and accept this case in order to clarify the scope of the waiver that arises from the filing of an action in federal bankruptcy court.

Respectfully submitted,

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[6] The states' uncertainty as to the implications of *Lapides* is exacerbated by its concern that the distinctions drawn in the opinion seem to be at odds with the facts of those cases. Only *U.S. F&G* involved the immunity of the United States in its own courts, while the other two, like the case here involved a sovereign in a different court. Nor does it appear that protection of tribal interests was a significant factor in *Potawatomi*. These discrepancies leave further ambiguity in how the opinion should be interpreted.